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# Chapter 1

## Reversing the neoliberal deformation of Europe

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In 2007 Jörg Hufschmid, the German political economist and inspirational campaigner, marked the 50th anniversary of the Rome Treaties with a trenchant critique of the 'neoliberal deformation of Europe' in which he outlines the degree to which the integrationist ambitions of the original authors of the European project had been diluted, distorted or simply abandoned by the leadership of both the Commission and its core member states since the early 1980s (Hufschmid 2007). In particular, Hufschmid underscored the 'increasing intra-community asymmetries' which politically and economically 'contain an explosive potential [...] which is massively endangering the unity of the EU in the medium term' (Hufschmid 2007: 314). Hufschmid survived to see the prescience of his remarks begin to take grim shape after the outbreak of the global crisis in 2008 before his untimely death in December 2009. His critique of the particular pathology of Europe's neoliberal illusions was matched by a refined understanding of the general pathology of financialised capitalism (Hufschmid 2002) and a deeply held apprehension of the imminent collapse of the house of cards. While the multiple crisis provided fairly unequivocal empirical proof of the long-term unviability of the neoliberal project and of the fundamental design weaknesses of the EU's policy architecture, the ideological illusions

persist – for some inexplicably (Crouch 2011; Lehndorff 2012) – in ‘zombie’ form (Quiggin 2010)<sup>1</sup>.

What follows below is an attempt to account for the ‘persistence of failed ideas’ in both the institutional arrangements of the European Union and the mindset of its defenders, to outline the severe damage they are doing to the peoples of Europe and their long-term prospects and to propose some alternatives to their deeply flawed policies. Let me start with two metaphors, described by Martin Jänicke in 1986 of the tank-driver and the cyclist in relation to two modes of policy-making:

A tank driver can be stupid and blind. In contrast to the cyclist, he does not need to adapt to the annoying obstacles of the environment. Problems are ‘externalised’: It is not the tank driver that is damaged but the environment. In the case of the cyclist, on the other hand, the problems of an adaptive method of driving are completely internalised.

(Jänicke 1986: 158)

The metaphors of cyclist (reflective adaptation) and tank-driver (blind refusal to reflect, learn and adapt) are arguably fully applicable to an analysis of the current dilemmas facing Europe. There are certainly few signs of adaptable cyclists in positions of power. The metaphors thus allow us to consider the reasons for Europe’s fatal addiction to failed recipes, in particular to the straitjacket of a currency union, whose policy architecture is stubbornly resistant to reflection or change. Four-and-a-half years into Europe’s worst social and economic crisis in many decades, the clinging of policy-elites to an intellectual corpse indicates above all a comprehensive misdiagnosis of the causes of that crisis. While the role of the financial services sector in triggering the crisis has clearly been acknowledged by EU-leaders, while regulatory reforms of banking have been initiated in most core member states, while even a Financial Transaction Tax within Europe is being proposed, these and related policy initiatives are dwarfed by the centrality of sovereign debt consolidation in Europe’s ‘reform’ agenda. The priority of fiscal consolidation, before any other macro-economic preferences, implies the primacy of ‘fiscal

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<sup>1</sup> See also P. Krugman ‘When Zombies Win’, *New York Times*, 19 December 2010.

irresponsibility' in the causal chain resulting in the global crisis. This primacy is clearly evident in the contradictory persistence during 2008 and 2009 of the Commission's 'excessive deficit' obsession in relation to new member states (Leaman 2012a: 175ff), particularly when most Central and Eastern Europe countries (CEECs) had lower public sector borrowing requirements (PSBR) and debt ratios than their counterparts in the EU15. This obsession was given European Central Bank (ECB) support at an early stage in 2009, as Europe was experiencing the worst recession in 80 years, when Jean-Claude Trichet asserted that states had reached the limit of indebtedness and would need to start reducing their borrowing in 2010 in order to reassure consumers and financial markets.<sup>2</sup> In April 2010, Trichet surprised one questioner by asserting and, on request, repeating the conviction that 'the market is always right, and has to be completely respected at all times' (cited in Lehndorff 2012: 7). Finally, and shortly before his departure as President of the European Central Bank in 2010, in a speech declaring the imminent restoration of full health to European capitalism, Trichet stated that all the ECB had to do was to accompany 'the market as it progressively gets back to normal'.<sup>3</sup>

Defining market 'normality' in empirical-historical terms would be difficult enough, given the wide variety of market relationships and dynamics both at given times and over time. The normality of 'oligopolies' or 'monopsonies', where concentrated economic power determines those dynamics, will arguably not have been Trichet's understanding. However, neither can the increasingly bizarre market conditions of the neoliberal era be understood as norms of sustainable economic activity to which we should ever dream of returning. Trichet's simple invocation of an infallible market is nevertheless deeply worrying, particular in the context of the scientific ruins of the efficient market hypothesis and the continuing paralysis of financial and investment markets in Europe.

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<sup>2</sup> 'ECB chief Trichet says governments have reached borrowing limit', *The Guardian*, 21 June 2009, retrieved from: <<http://www.theguardian.com/business/2009/jun/21/ecb-trichet-budget-deficit-warning>> (last accessed 1 October 2013).

<sup>3</sup> 'Interview with Jean-Claude Trichet', *Financial Times*, 8 September 2010, retrieved from: <<http://www.ecb.europa.eu/press/key/date/2010/html/sp100910.en.html>> (last accessed 1 October 2013).

Discounting market fallibility *à la* Trichet thus pre-programmes the colossal misdiagnosis of the extent, severity and implications of Europe's multidimensional crisis (See Box 1.1).

#### Box 1.1 Europe's multiple crises 2007–2013

1. A *functional crisis of the global system of financial services*; banking and related services have become incapable of 'servicing' the circuits of production, service-provision, investment and consumption;
2. A *cyclical crisis* of production, consumption, trade, investment and employment, which is threatening to become a regional 'slump' greater than that of the 1930s;
3. A *structural crisis of 'over-commitment'* to financial services as vehicle of growth; this in turn involves a fundamental crisis of capitalist commercial psychology, notably of the exaggerated profit-expectations underpinning Ponzi-capitalism; public and private pension funds, social insurance funds, private investment funds, private and corporate shareholders had become fatally addicted to the unsustainably high rates of return, provided by hyper-leveraging and hyper-appreciation of financial assets;
4. A *crisis of the 'growth' paradigm* as policy vehicle for ensuring economic and social equilibrium, where the simple saturation of markets and increasing elasticity of demand renders the delivery of convenient incremental increases in output less feasible; the temporary illusion of growth and affluence provided by Ponzi-style circuits of fictitious capital can be seen as a desperate attempt to defy the reality of the increasingly limited growth potential of affluent societies;
5. A *continuing crisis of the 'growth' paradigm as basis for planetary survival*; the depletion of resources, bio-diversity, habitat-quality, along with the consequences of man-made global warming, pose colossal challenges to current generations in their efforts to bequeath a viable bio-sphere to future generations.

6. The first four crises above amount to a clear *crisis of the neoliberal paradigm*; the bankruptcy of the 'efficient market' hypothesis and the illusions of 'the' market's self-healing properties are evident and crass.
7. The failure by 'epistemic policy communities' to acknowledge the intellectual bankruptcy of the neoliberal paradigm betokens a continuing *crisis of economic discourse*, characterised by an institutionalised resistance to reflection and to holistic, interdisciplinary approaches to human social and economic relationships which acknowledge the profound (global and societal) interconnectedness of those relationships;
8. This in turn has revealed a *deep crisis of economic management*, characterised by the utter powerlessness of monetarist inspired independent central banks to control the 'liquidity factories' of casino capitalism (Phillips 2008; Mellor 2010); the theological centrality of the quantity theory of money was rendered absurd by the embarrassing inability of either Bundesbank or ECB leaderships to explain the disparity between a ballooning money stock and low growth and low aggregate inflation (Leaman 2012b). Europe's policy architecture, built so confidently around the separation of a dominant central monetary authority and subordinate national fiscal authorities looks clearly inappropriate as a means of mastering the above multiple crises and maintaining democratic legitimacy in the process.

The above clearly betokens much more than a temporary cyclical or structural crisis of an otherwise secure mode of production, and rather an *existential crisis of capitalism itself*, unheeded by its corporate elites and its political 'managers' alike. It is thus very much 'different this time'. The resultant recoveries from 'the' crisis are therefore very unlikely to follow the patterns exhibited by states in earlier financial crises, as Reinhart and Rogoff (2009) suggest.

A central argument of this paper is that the scale and effect of Europe's on-going multiple crisis have been systematically trivialised by policy-makers, with corresponding implications for their crisis management priorities. There have been several attempts to quantify the scale of the global crisis in terms of output losses. One is in fact an occasional paper by staff at the Commission's Directorate General for

Economic and Financial Affairs (DGFEA) (European Commission 2009) which strikes a very sober note of warning in its preliminary assessment of the long-term effects of the crisis, presenting both 'optimistic' and '*pessimistic/realistic*' scenarios of losses in output and investment within the EU over twenty years. Both scenarios foresee permanent output losses: of 0.5 per cent in the optimistic variant and 4.5 per cent annually in the pessimistic variant (Figure 1.1). The findings of the DGEFA paper are in line with both specific studies of the 2008 crisis (Haldane 2010a) and the general conclusions of comparative studies of historical financial crises (Abiad *et al.* 2009); however, for whatever reason, the DGEFA paper does not translate the warning into a set of prescriptive policy proposals, in contrast to Abiad *et al.* (2009: 27) who at least imply that countervailing fiscal measures reduce the deviation from trend growth!

The DGEFA paper, even as early as 2009, nevertheless acknowledges that pessimism over recovery and long-term prospects represents the 'realistic' scenario. It also underscores the potential effects of an extended crisis on a broader set of variables within the economies of the EU27. Beyond the permanent loss of output and unused capital stock, the paper also talks about a possible 'permanent destruction in human capital, leading to an irreversible (sic author) rise in the structural unemployment rate' (European Commission 2009: 14); a 'protracted recession' might also reduce the labour force participation rate by 'discouraging vulnerable workers from seeking a job' (*ibid.*); furthermore growth rates and productivity could be adversely affected by specific crises in vulnerable branches of the economy like financial services, construction and motor vehicles (European Commission 2009: 15) and by a 'slow process of industrial restructuring'; finally growth and productivity 'could also be permanently affected by a reduction in innovative activities due to lower (private) research and development (R&D) investments, which tend to be cyclical, and more limited opportunities for the transfer of knowledge (*ibid.*).

- The permanent waste of human capital is already palpably evident in the high levels of *youth unemployment* in the whole region (Figure 1.2); November figures showed an average rate of youth unemployment at 23.7 per cent for the EU27 and 24.4 per cent in the eurozone, with Greece (57.6 per cent) and Spain (56.5 per cent) the leaders of a grim table of squandered 'human capital'. Micro-level studies of early career unemployment (Gregory and Jukes

2001; Gregg and Tominey 2004) have already identified a permanent ‘scarring effect’ on later average earnings. The worsening of already high structural unemployment among 15–24 year-olds arguably allows us to conclude that such scarring in Europe will be

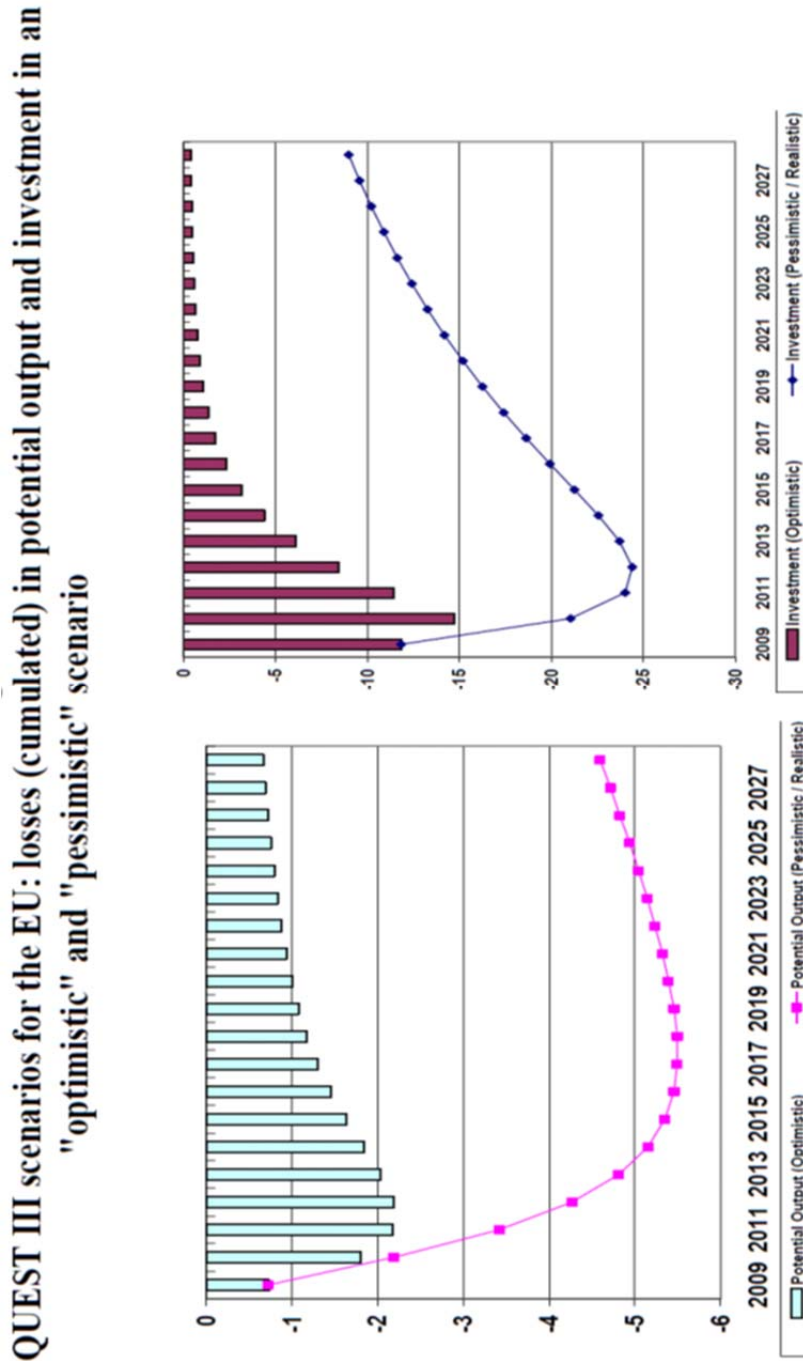


Figure 1.1: Losses in potential output in EU27 2008–2027 (estimated)

Source: European Commission (2009) *Impact of the Current Economic and Financial Crisis on Potential Output, Occasional Paper*, Brussels, p. 8.



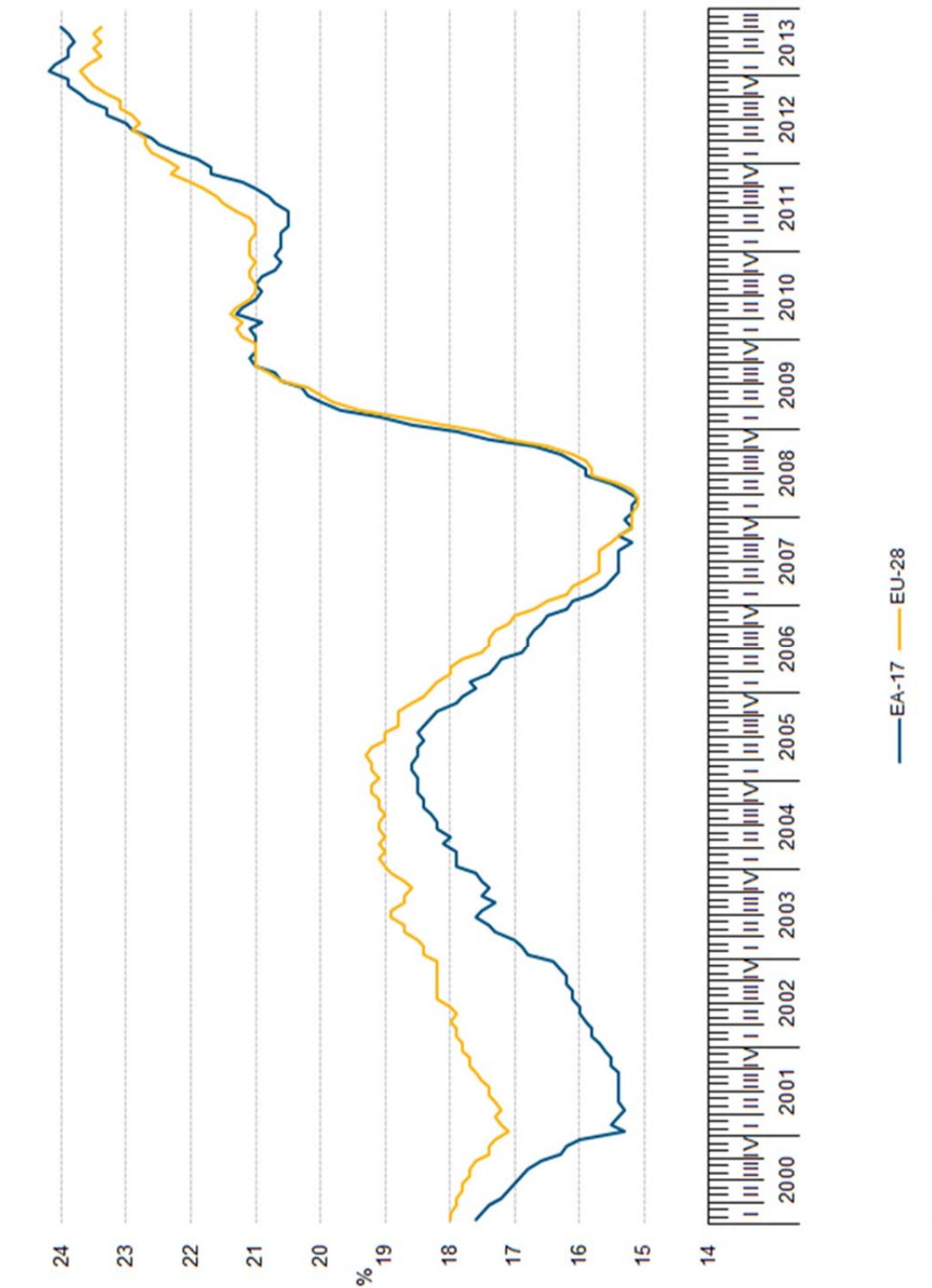


Figure 1.2: Youth unemployment in Europe (EU27 and eurozone) 2000–2012

Source: Eurostat (2013) 'Unemployment rate by sex and age groups – monthly average, %'. Retrieved from < [http://appsso.eurostat.ec.europa.eu/nu/show.do?dataset=une\\_rt\\_m&lang=en](http://appsso.eurostat.ec.europa.eu/nu/show.do?dataset=une_rt_m&lang=en) > (last accessed 8 October 2013).

chronic for current generations. International Labour Office research also demonstrates the disproportionate level of youth unemployment in social groups with lower levels of educational attainment (International Labour Office 2012: 46).

- Eurostat data for 2011 confirm a trend towards a lower *participation rate*, from 65.3 per cent of the 15–65 year-olds in 2007 to 64.3 per cent in 2011, but again with severe falls in Greece from 61.4 per cent to 55.6 per cent, and Spain (65.6 per cent to 57.7 per cent).

These figures, however, are clearly distorted by the wide variance in part-time employment (Figure 1.3), with an EU27 average of 19.4 per cent of total employment but with comparatively low part-time ratios in less developed and newer member states (the 12 new member states plus Portugal and Greece have an average of just 8.4 per cent part-time employment). It can therefore be argued that the higher part-time employment ratios in the old core member states of the EU15 mitigate the scarring effect of early career unemployment, even if those figures conceal higher levels of under-employment in more developed economies.

The pre-existing disparities in *Research and Development (R&D) Intensity* have been both acknowledged by the EU, and their reduction was made one of the main targets of the Lisbon 2020 strategy (European Commission 2007). Again the core-periphery distribution of R&D expenditure is marked, with Estonia, Slovenia and the Czech Republic the exceptions that prove the general rule of a high concentration in the northern core states. However, the EU average of 1.98 per cent of the gross domestic product (GDP) remains significantly behind that of both Japan and the USA, with China already converging on static European levels in 2005 (*ibid*: 76). The case of Greece is instructive, firstly because its R&D ratio is modest at 0.58 per cent of GDP and, secondly, because it is overwhelmingly represented by the public sector in contrast to the major players in the region where the public/private funding-mix is seemingly more balanced (*ibid*.: 82); this should not deflect attention from the general problem of cuts to research-funding that have been mooted at both MAFF-level and at that of member states. It nevertheless reinforces the suspicion that, without a radical redirection of Structural Funds or a general reversal of austerity programmes at member state level with a strong focus on modernisation through R&D, the Lisbon targets (Figure 1.4) will be missed, and that private funding

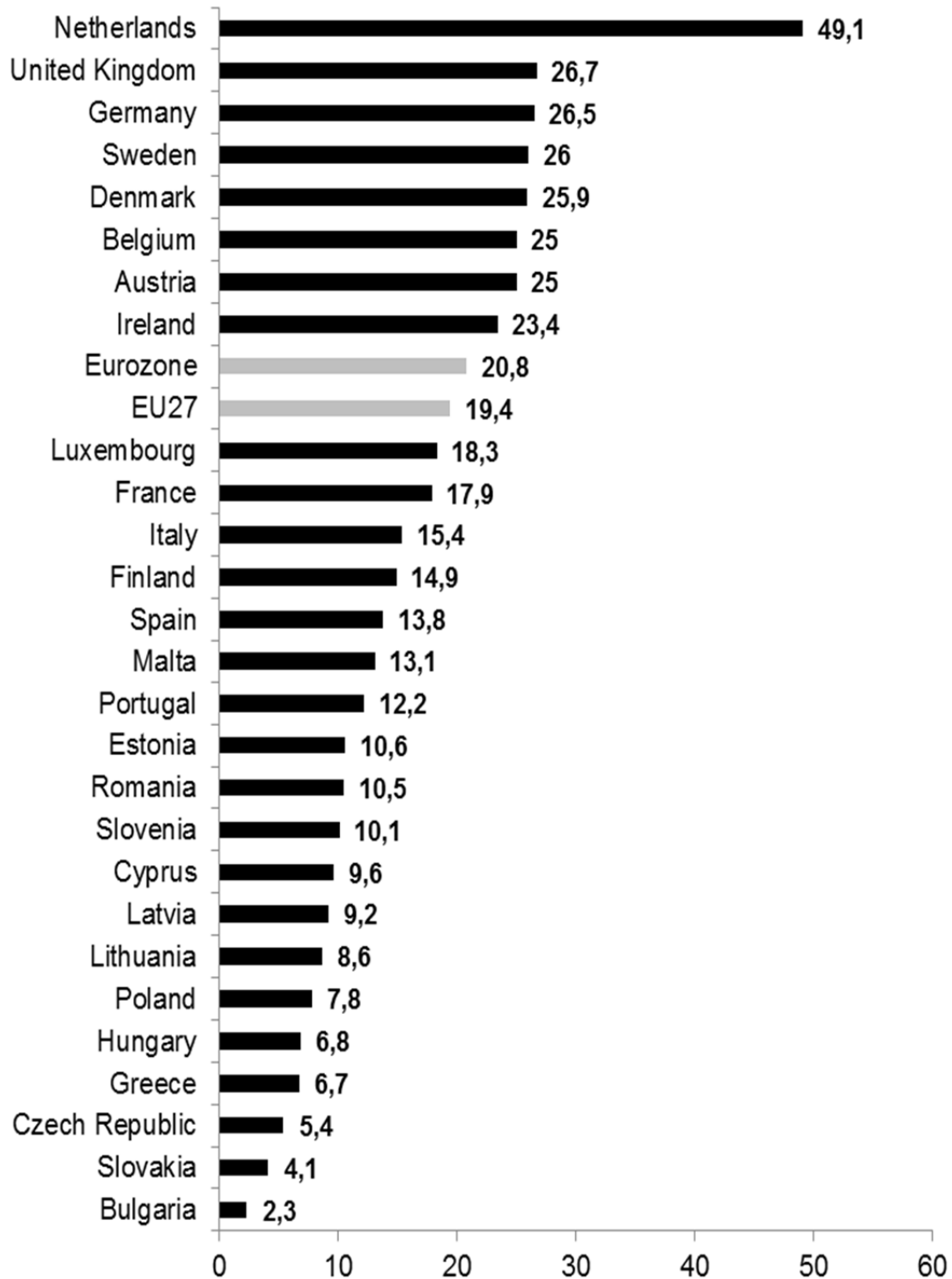


Figure 1.3: Part-time employment in the EU27 as a proportion of total employment in 2011

Source: Eurostat (2012) 'Around 8.5 million part-time workers in the EU27 wished to work more hours', Newsrelease 12/61.

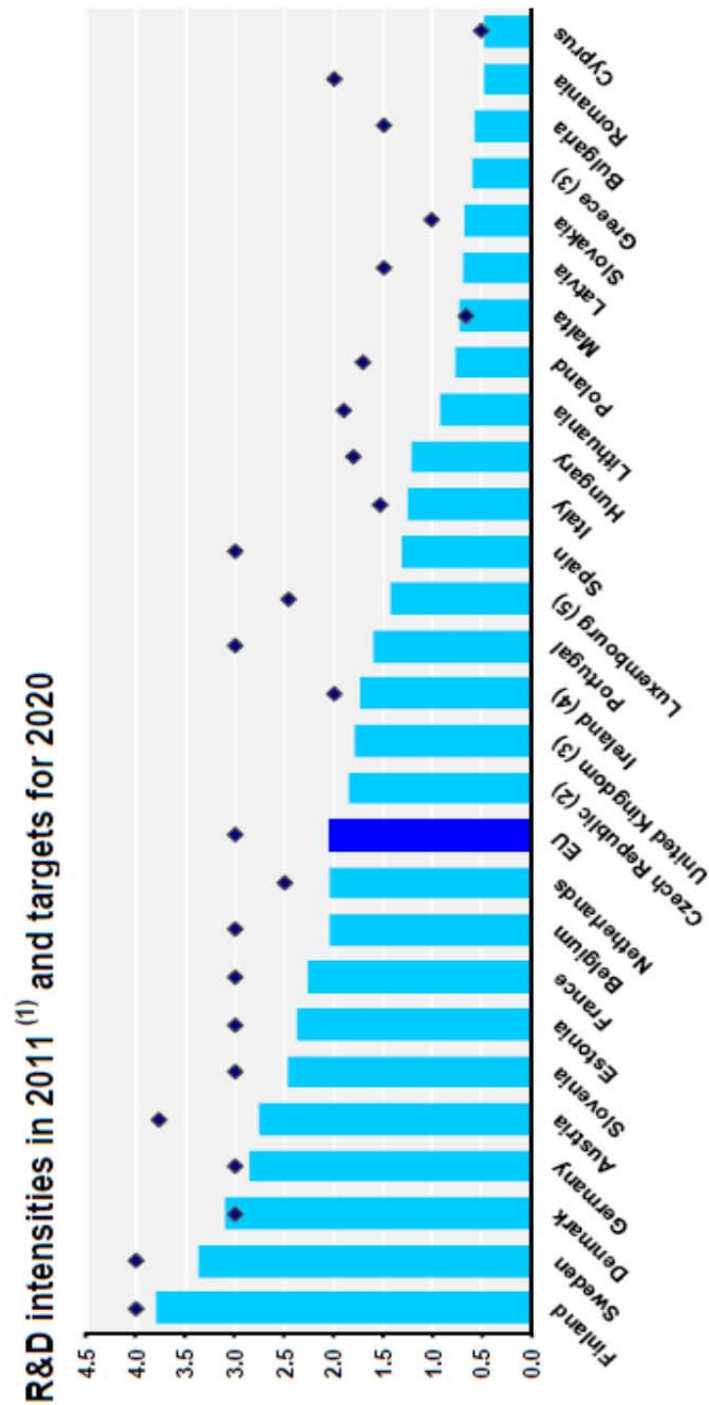


Figure 1.4: Expenditure on research and development as a proportion of GDP in per cent

Source: European Commission (2011) 'Europe 2020 Targets: Research and Development'. Retrieved from: <[http://ec.europa.eu/europe2020/pdf/themes/15\\_research\\_development.pdf](http://ec.europa.eu/europe2020/pdf/themes/15_research_development.pdf)> (last accessed 13 August 2013).

Notes

(1) EL: 2007; PT: 2010; (2) CZ: A target (of 1 %) is available only for the public sector; (3) CZ: A target (of 1%) is available only for the public sector; (4) UK: A targets for 2020 is not available.

will gravitate towards the established centres of innovation. Greece, for example, has experienced six successive years of severe contraction in investment (a fall of 86.4 percentage points from 2006!)<sup>4</sup>, and cannot realistically be expected to attract research-intensive monies from either domestic or foreign sources.

The DGEFA's pessimistic forecast of additional knock-effects of a 'protracted recession' (apart from permanent output losses of trillions of euros) would therefore seem to be grimly accurate, judged from this brief survey of the current situation, four years on.

## Neoliberalism, monetary accumulation and the dilution of value

The neoliberal catastrophe is not confined to the recent bursting of financial asset-bubbles and its social and political aftermath, however. The process of *value-dilution* arguably began almost simultaneously with the conversion of policy-makers and their wider community of academic and administrative advisers (their 'epistemic' community) to monetarism and Thatcherite supply-sidism. A recent study of the British economy by Martin Weale demonstrates in graphic form two major periods of value-destruction since the 1920s, the first beginning in 1930 through to the end of the Second World War, the second starting in 1980.

Weale himself does not employ the concept of 'value-destruction' but of economic 'sustainability' threatened, as he sees it, by the decline of the UK's wealth-to-GDP ratio (Weale 2012: 62ff) – where wealth is defined as capital stock plus net foreign assets and net national saving. His analysis nevertheless provides an eloquent illustration of the similar effects of depression/war on the one hand and the neoliberal paradigm on the other, inasmuch as the weakening of the overall wealth ratio between 1930 and 1945 was followed by a gradual recovery up until 1980, 'after which it has declined sharply again' (*ibid.*), reaching the historically low level of 1945 again between 2000 and 2005 (see Figure 1.5). Weale stresses the significance of the weakened wealth ratio in terms of intergenerational equity, where the over-consumption of recent generations is judged to leave a less viable foundation for future welfare than the one inherited in 1980. However, Weale's data also provide ammunition for demonstrating the allocatory

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<sup>4</sup> Figures from OECD *Economic Outlook* 92, October 2012.

diseconomies of the paradigm of 'monetary accumulation' as a function of poorer investment and saving between 1980 and 2005. These weakened the long-term resilience of the UK economy, even before the further wealth-destruction during the 2008–9 crash. His analysis also suggests that similar conclusions can be drawn from the general decline of the investment ratio in *all* advanced economies. The following remarks seek to demonstrate the destructive effect of neoliberalism in terms of both overall investment and the particular role of public investment in sustaining social and economic welfare.

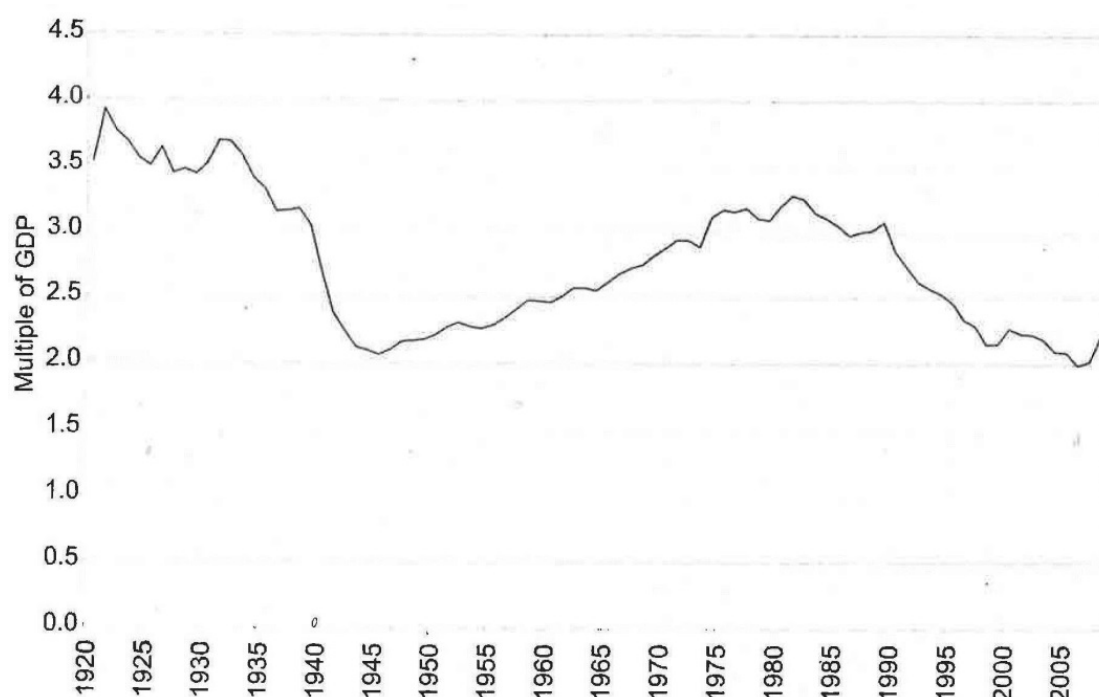


Figure 1.5: Ratio of produced wealth to GDP in the UK 1920–2005

Source: Weale, M. (2012) 'Unsustainable Consumption: The structural flaw behind the UK's long boom', in Giudice, G., Kuenzel, R. and Springbrett, T. (eds) *UK Economy: the Crisis in Perspective*, London: Routledge, p. 62.

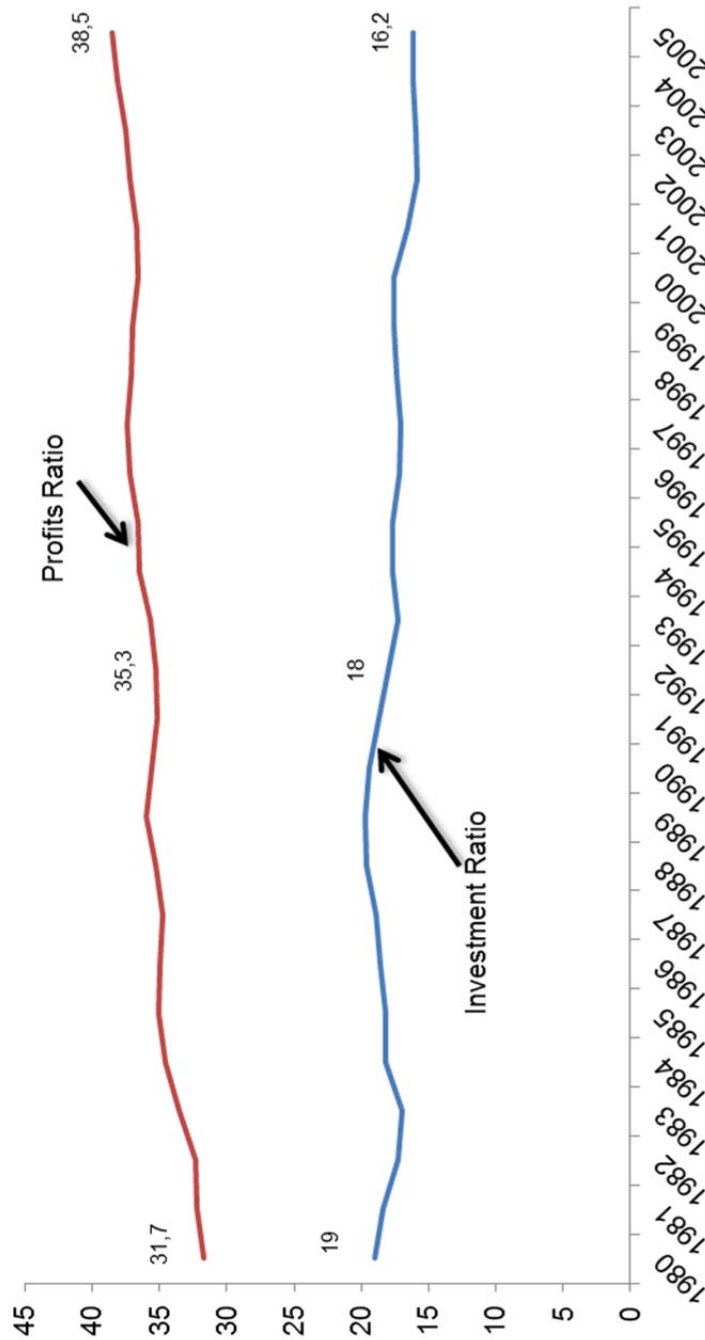


Figure 1.6: Profits ratio and investment ratio in advanced economies 1980–2005.

Source: International Monetary Fund (2007) World Economic Outlook, Washington, DC: International Monetary Fund. Retrieved from: <<http://www.imf.org/external/pubs/ft/weo/2007/01/pdf/text.pdf>> (last accessed 24 September 2013). Data from Charts 1.15 and 5.7; profits ratio defined as the share of income from capital in national income before tax and transfers; investment ratio is the proportion of gross fixed capital formation to GDP in any given year.

Figure 1.6 above provides strong evidence disproving neoliberal claims of the efficacy of supply-side reforms on real economic growth in the world's advanced economies. IMF data for both the share of profit income in net GDP (national income) and gross fixed capital formation as a proportion of GDP contradict the claim that higher profit income generates higher real investment; a 6.8 percentage point rise in the profits ratio in advanced economies between 1980 and 2005 stands in stark contrast to the 2.8 percentage point decline in the investment ratio. The assumed virtuous circle of higher profits, facilitated *inter alia* by tax relief and labour market reforms, leading to higher investment, higher production levels, higher employment and a new sustainable, market-driven dynamic economy, falls at the first hurdle.

Given that the linkage between investment and growth is fairly robust (see Rajan 2010: 70), that the investment ratios of the EU's core economies have been on a declining trend for some time, that the rise in the European profits ratio in the observed period was even greater than the OECD average (at over 9 percentage points) and that Europe has been the world region with the most anaemic growth rates for two decades, one is justified in asking: what went wrong with the supply-side growth revolution? A very brief survey of the actual processes of the neoliberalisation of markets since the 1980s is necessary to explain the mal-functioning of supply-side transmission mechanisms in the macro-economy.

- Neoliberal reforms of the state included the extensive *privatisation* of state assets, many of them natural monopolies like the gas, power and water utilities or public transport networks and hubs (airports, ports); while telecommunications became increasingly subject to the competitive influence of cable and satellite technologies, most utilities remained natural monopolies, inaccessible to genuine market competition and its associated price efficiencies. The most popular solutions to the problem of the potential abuse of monopoly pricing in such utilities were the political regulation of rates of return (favoured in the US) or price/tariff changes (UK), with regular adjustments according to set formulae. Such regulatory systems operated on the assumption that there must be continuity of supply, provision for modernisation and long-term investment *and* (implicitly or explicitly) a guaranteed return on capital (see Stern 2003: 22). It is unsurprising that the performance



of such regulated monopolies has ensured higher returns on capital than applies to the SME sector (Candeias 2009); their revenues represent *monopoly rents* guaranteed for given contractual periods. Such privatisation programmes became *core elements of state policy* in advanced states and of the development policy of advanced states and supra-national institutions like the World Bank and the European Union.

- An extension of straightforward privatisation of state-owned assets was the introduction of '*public-private-partnerships*', involving the private financing of public building and civil engineering projects and medium- to long-term leases granted to the companies with guaranteed income streams from the public institutions (in education, health, transport etc.), operating their services from the facilities. A strong determinant motive in such schemes was the desire by state authorities to minimise the effect of such public sector projects on the state's borrowing requirements in a period (1990 to date) dominated by the monetarist strictures of deflation and debt-consolidation. Such projects nevertheless also involved guaranteed monopoly rents within contracts that have been frequently criticised for their generosity towards the private partners. Recent official UK studies of the efficacy of the 700 or so PFI projects also cast serious doubt on both their underlying principles and their viability (e.g. House of Commons 2011).
- Against this background of state policies helping to engineer higher than average rates of return on capital through guaranteed monopoly income streams, the investment options open to companies with growing capital reserves already militated against the risk of simply expanding and modernising capacity in traditional commercial sectors; more significantly the privatisation programmes raised expectations of rates of return that would become increasingly difficult for such traditional sectors to deliver (see Haldane 2010b: 13). What then emerges from the parallel accumulation of corporate reserves in the MNCs of advanced states and the transfer of '*petro-dollars*' from rich oil-producing states to the financial institutions of the North is a highly liquid global market for finance capital in search, not of secure but modest long-term returns on invested capital, but of increasingly high returns on capital that is committed for ever shorter periods of time (Huffschnid 2002).

- In addition to these determinants of rising ROR expectations, in the early 1980s the monetary authorities of the advanced economies – led by the Federal Reserve – presided over a sudden *increase in real interest rates* which increased bond yields to historic highs; this was driven both by orthodox monetarist deflationary policies via higher central bank base rates, but also by the fairly unorthodox strategic military programmes of the Reagan administration and their heavy reliance on deficit-spending. Accordingly, US 10-Year real bond yields reached 14 per cent in 1982. One commentator describes returns on bonds in recent decades as ‘super-sized’, noting that ‘real bond returns after inflation in both the US and UK have been on average 5.9 per cent compound per annum – some three to four times the long term average respectively’<sup>5</sup>. Such returns on state guaranteed financial assets thus also contributed to increasing levels of expectation on the part of major investors, particularly in a period of low or negative growth, preparing the ground for the wholesale revolution in financial services that ensued (see Huffs Schmid 2002; Mellor 2010; Phillips 2008; Tett 2009).

The important feature of the paradigm shift to financialised capitalism and monetary accumulation was that it was constructed on the *illusion of enhanced wealth-creation*, of the appreciation of paper assets which of themselves would produce ‘value’ and improve the welfare of citizens on a sustainable basis. Even a UK Treasury economist, like Andrew Haldane, demonstrates rather that the contribution of the financial sector to growth and ‘value’ was in large measure a ‘mirage’ (Haldane 2010b). The mirage of seemingly effortless value-appreciation through the operation of financial circuits nevertheless maintained an astonishing level of credibility among policy-elites, credit-rating-agencies and the academic community, defying the warning signs of the East Asian Crisis of 1997, the Enron debacle of 2001 and the ‘dotcom’-crisis of 2001–2, as well as the intuitive logic of observers who suggested it was difficult to create value out of ‘thin air’ (Mellor 2010 etc.). Nevertheless, the ‘fool’s gold’ paradigm (Tett 2008) was only revealed to be what it was to wider sections of global civil society when the

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<sup>5</sup> ‘Are Government Bonds in Developed Markets Overvalued’, *Gillen Markets*, 1 April 2011, retrieved from: <[http://www.gillenmarkets.com/featured\\_articles/are-government-bonds-in-developed-markets-overvalued.cfm](http://www.gillenmarkets.com/featured_articles/are-government-bonds-in-developed-markets-overvalued.cfm)> (last accessed 13 August 2013).

affairs of Lehmann brothers, AIG etc. became public in the autumn of 2008. Haldane's account of the 'productivity miracle' of financial services is persuasively simple, inasmuch as he uncovers the basic accountancy tricks of banks and other institutions which allowed them to create vast quantities of liquidity without altering the 'health' of their visible balance sheets or increasing their basic capital. They achieved this through a combination of hyper-leveraging (borrowing) and securitisation (converting loans/liabilities into securities/assets based on future income streams). Far from suggesting a dilution of the asset-side of the balance sheet, such operations – often through so-called special-purpose-vehicles (SPVs) belonging to the same bank – the asset-side was seemingly increased by the on-going appreciation of the bonds (CDOs, ABSs etc.) on secondary markets and the persistence of triple-A ratings delivered by compliant credit ratings agencies. The colossal liabilities represented by leverage ratios of 'more than 50 times equity at the peak of the boom' (Haldane 2010b: 15) were thus spirited off balance sheets in smoke-and-mirrors operations involving multi-layered ownership structures, shell companies and offshore secrecy jurisdictions.

The deployment of so much liquidity in the febrile capital markets of the 1990s and 2000s allowed a corresponding increase in the rate-of-return on equity (ROE): 'the level of ROEs was consistently at or above 20 per cent and on a rising trend up until the crisis. This is roughly double ROEs in the non-financial sector over the period' (Haldane 2010b: 13). Moreover with the banks 'engaged in a highly competitive ROE race' (*ibid.*), the pressure to continue the leverage/securitisation merry-go-round was very high, suppressing what remained of scepticism and prudence at the level of executive boards, investment analysts, credit ratings agencies and institutional investors. Such *post hoc* insights by a Treasury insider beg the question as to why there were so few warnings from the policy elites of advanced states and of supra-national institutions, when financial ROEs were so clearly abnormal.

The dilution of real wealth in the decades of the recent three decades of financialised capitalism is also evident in the changing shape of the asset holdings of 'non-financial institutions' (NFEs) or 'non-banks'. Figures from the European Central Bank (2007) covering the balance sheet composition of all NFEs in the eurozone show that between

1995 and 2005, the ratio of their financial assets to tangible fixed assets more than doubled from an average of 0.53 to 1.18.

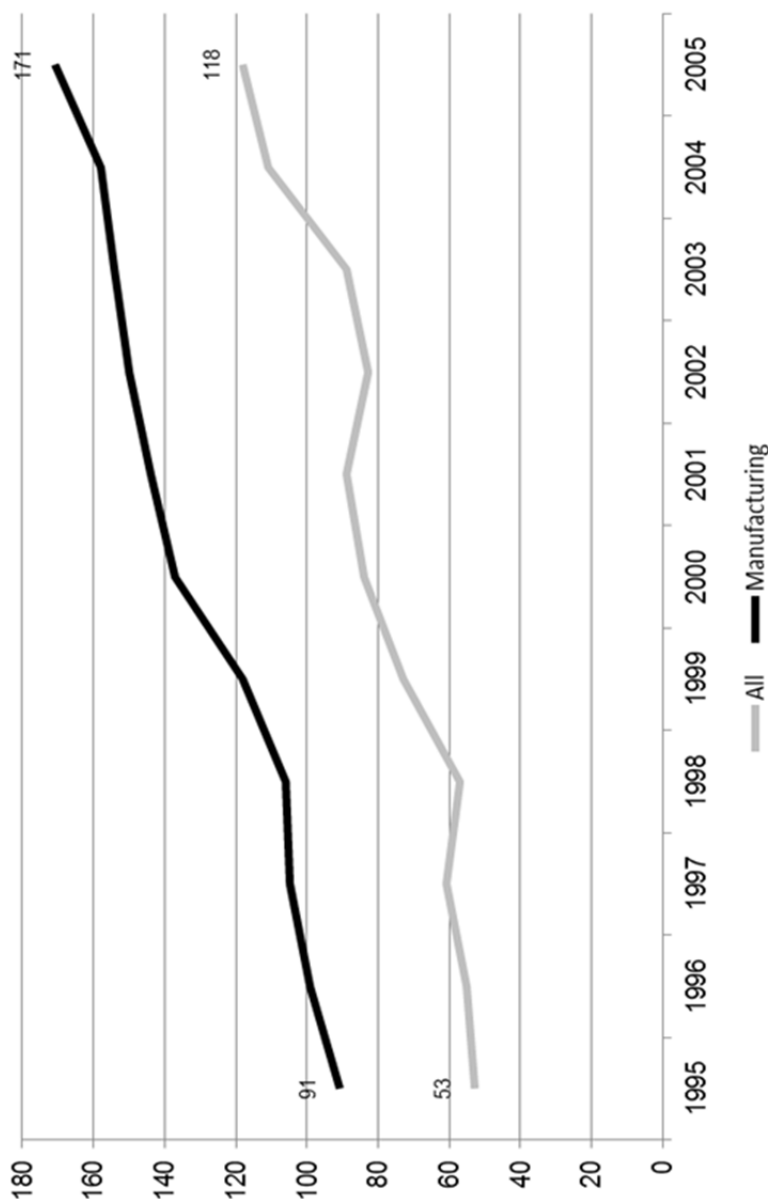


Figure 1.7: Ratio of financial to fixed capital in eurozone non-financial enterprises 1995–2005

Source: European Central Bank (2007) 'Corporate Finance in the Euro Area with Some Background Materials', Occasional Paper No 63/ June, p. 21.

Most striking is the transformation of the balance sheets of manufacturing enterprises with financial assets in 2005 totalling 171 per cent of physical assets (see Figure 1.7), a virtual doubling in just ten years. Figures for the individual branches of Germany's dominant

manufacturing sector show a marked trend towards the financialisation of their asset portfolios in the previous decade-and-a-half between 1980 and 1985, with motor manufacturers reaching an average financial asset ratio of 1.57, electro-technical corporations 1.76 and German chemical TNCs a ratio of 2.0 (see Leaman 2009: 80f). The not infrequent references to Siemens and Daimler-Benz as banks with manufacturing subsidiaries find strong empirical support from such data.

A critical determinant of this historically unprecedented shift in the way in which industrial corporations valorised their capital, deriving sizeable proportions of their operating profits from financial securities, rather than the sale of products and services, was the adoption of 'shareholder-value' as the predominant measurement of commercial success. Lazonick (2011) identifies the particular role of stock (share) options in the remuneration packages of senior managers in driving this process in the United States. The option to be rewarded by extra tranches of a company's stock skewed incentives, according to Lazonick, particularly within larger corporations, towards short-term commercial strategies designed to drive bull markets.

With average compensation in the Top 100 US corporations varying from 'lows' of \$18.2 million (1994) and \$103.7 million (2000), stock options accounted for well over two thirds in most years in the period 1992–2008 (Lazonick 2011: 8). One of the most potent vehicles for generating significant increases in corporate share values was in the (frequently hostile) takeover of other enterprises or the acquisition of majority holdings in other corporations. Figure 1.8 shows how dramatic the two waves of global takeovers were between 1990 and 2006, with record deal values of \$4 trillion in both 2000 and 2006. The efficacy of mergers and acquisitions activity, as noted above, is strongly contested by a number of studies, one suggesting that 70 per cent fail (Campbell *et al.* 2008), another that hostile takeovers have a generally worse record (Martynova *et al.* 2006); in the case of banks, Haldane cites research suggesting that 'economies of scale in banking are exhausted at relatively modest levels of assets, perhaps between \$5–10 billion' and that subsequently there 'is no strong evidence of increased bank efficiency after a merger or acquisition' (Haldane 2010a: 11).

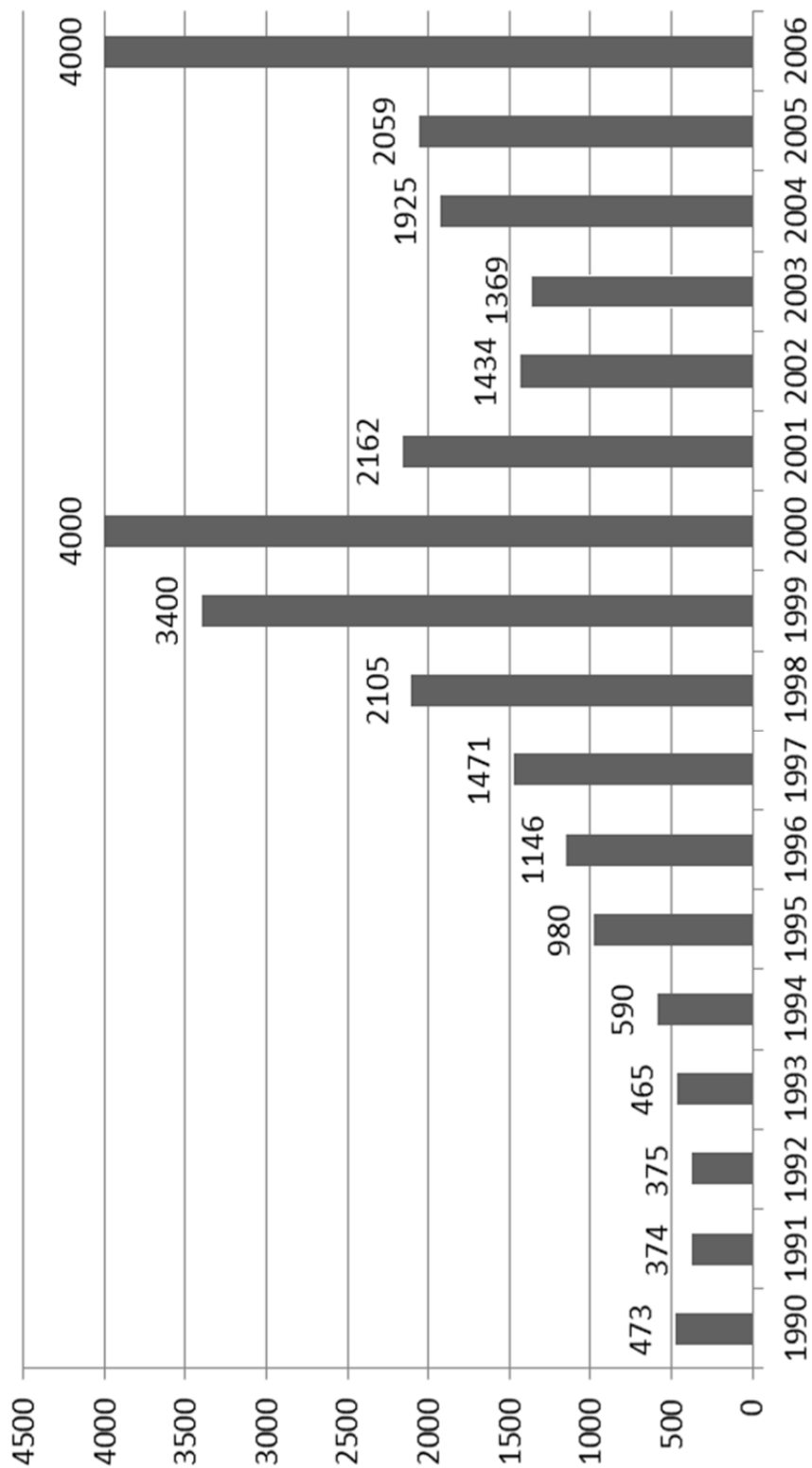


Figure 1.8: Global mergers and acquisitions 1990–2006. Value in USD billion

Source: Dealogic, M & A Analytics, statistical platform, available at <http://www.dealogic.com/investment-banking/ma-analytics/> (last accessed 15 October 2013).

Against the background of the 'common knowledge' that 'most M&A activity is value-destroying', as asserted by a mainstream economist (Haldane 2010b: 21; my emphasis), his subsequent assessment of the extraordinary degree of concentration in the banking sector, particularly after the repeal of the Glass-Steagall Act in the US in 1999 (Haldane 2010a: 6 and 18) supports the view of many heterodox economists that the 'merger mania' of the last two decades generated colossal gains for the minority of banking and other corporate executives involved in hyper-leveraged buyouts, but equally colossal risks for the compliant and complacent states and their respective citizens, risks that exploded in the autumn of 2008 and the costs of which have not even yet been remotely grasped by policy 'elites' at political or corporate level.

The role of the neoliberal state in the transformation of European and global capitalism is inherently contradictory, inasmuch as the executive decisions of key national administrations have involved a conscious self-marginalisation, withdrawal from the responsibility of key allocatory functions within national and regional political economies. Both the territorial mobility and, above all, the effective privatisation of money-creation by corporations (Box 1.1 above), has rendered states and supranational political institutions increasingly powerless to manage either fiscal or monetary affairs effectively.

The political disempowerment of politics *qua* management of the political economy produced what Richard Murphy terms the 'cowardly state'. Of fundamental significance, finally, in the process of weakening the asset-base of European political economies has been the particular decline of *public investment* as a critical ingredient of social progress. Gomez and Pouget (2008) chart the decline of public investment in 21 OECD economies from some 4.5 per cent of GDP in the early 1970s to less than 3 per cent in the most recent decade (Figure 1.9). The pattern of decline is not identical in all economies, but most marked in Europe's core economies (France, Germany, the Netherlands, Britain). The authors seek, in particular to draw a correlation between the provision of public infrastructural assets and overall investment and align themselves with those who assert that (inward) real investment by private companies is more strongly determined by the provision of public goods than by benign corporate tax regimes, in that 'the provision of public capital creates rents for the firms' (Gomez and Pouget 2008: 7). They in fact go on

to postulate both the positive multiplier effect of state investment on growth and private investment (as demand-side variables) and the negative effects of strategic reductions in both public investment and rates of corporation tax (as supply-side variables).

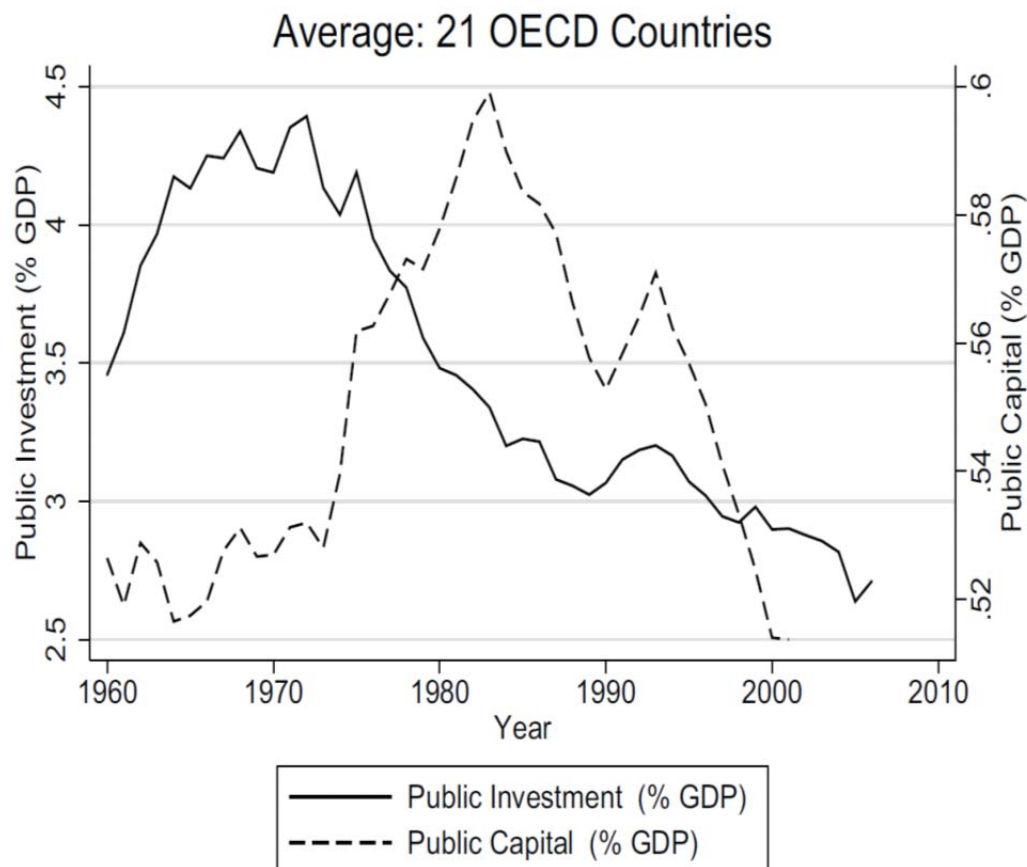


Figure 1.9: Public investment and public capital in the OECD 1960–2010

Source: Gomez, P. and Pouget, F. (2008) 'Corporate Tax Competition and the Decline of Public Investment', European Central Bank Working Paper 08/928, Frankfurt: European Central Bank, p. 7.

The findings of this persuasive working paper by staff at the European Central Bank cast serious doubt on neoliberal orthodoxy and strengthen the case of heterodox economists in their espousal of both demand-side strategies and a reinvigorated, active state. Moreover, these findings are supported by recent, persuasive research into fiscal multipliers (Coenen et al. 2012; Auerbach and Gorodnichenko 2011) as well as the extraordinary acknowledgement of mistakes by senior IMF analysts (Blanchard and Leigh 2013). The relevance of such findings (from, among others, staff of two pillars of



the Troika) for the analysis of Europe's current crisis of economic management is, along with the evidence presented above, good reason to assert the catastrophic consequences of Europe's persistence with state inaction and austerity.

## The tank-driver ploughs on: The destructive consequences of EU policy-paralysis

The reconvened budget summit of the European Council on 7 and 8 February 2013, produced a set of general conclusions (European Council 2013a) and a second document (European Council 2013b) devoted to the European Union's Multiannual Financial Framework (MFF). Both documents provide significant indicators of the mind-set that is driving the EU's macro-economic strategy. Both documents are a serious cause for concern. Their intellectual 'logic' defies both the evidence of the last thirty years of European economic history and the last four years of crisis-'management'. The 'triumph' of an agreed compromise<sup>6</sup> on the EU's budget for seven years from 2014 to 2020 should provoke the strongest possible response from academic economists and political economists, along with the rest of Europe's active civil society groups. The bankruptcy of Europe's 'depression economics' (Krugman 2008) and the imposition of Brüning-style austerity should and hopefully will be judged the most dismal 'triumph of failed ideas' (Lehndorff 2012; see Crouch 2011) in recent years.

If we take the MFF first, the trajectory of the proposed expenditure reductions is pro-cyclical in nature, compounding the thrust of member states' austerity programmes, and neoliberal in spirit, reducing an already modest pool of collective resources even further and, with it, the opportunity to promote shared prosperity through the financing of European public goods. Table 1.1 compares the most recent budget cycle (2007–2013) and the new MFF in terms of the proportions of EU Gross National Income represented by 'payment appropriations' (real planned expenditure) and 'commitment appropriations' (maximum hypothetical expenditure including contingency funds). Actual expenditure levels for the (current) 2007 cycle can be seen to rise from 1 per cent of the gross national income (GNI) to 1.05 per cent in 2013 (1.06 per cent average for the cycle), while the expenditure plans for the cycle beginning next year envisage a GNI-

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<sup>6</sup> See 'Cameron's Euro Triumph', *The Telegraph*, 9 February 2013.

share falling from 0.98 per cent of GNI to 0.91 per cent in 2020, a drop of 14 basis points (over 13 per cent) in seven years.

Table 1.1: EU multiannual financial frameworks 2007–13 and 2014–20 compared

<b>Appropriations as percentage of gross national income</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>7 Year average</b>
Total commitment appropriations	1.02	1.08	1.16	1.18	1.16	1.13	1.12	1.12
Total payment appropriations	1.00	1.05	1.04	1.12	1.09	1.08	1.05	1.06
	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	
Total commitment appropriations	1.03	1.02	1.00	1.00	0.99	0.98	0.98	1.00
Total payment appropriations	0.98	0.98	0.97	0.92	0.93	0.93	0.91	0.95

Source: European Council, Conclusions (Multiannual Financial Framework), EUCO 37/13, Brussels, 8 February 2013.

#### Notes

The 2014–20 budget cycle assumes an enlarged EU from 2013 to 28 member states, including Croatia.

It is also noteworthy that the starting-point for both expenditure ratios in 2014 is lower than the end-point ratios for the last budget-cycle (0.98/1.03 against 1.05/1.12). The process of budget reductions is described in §1 as ‘smart fiscal consolidation’, matching the ‘smart growth’ rhetoric of the Lisbon agenda, repeated in the MFF §13. It will not have escaped the attention of neutral observers that growth – smart, scruffy or otherwise – has been stubbornly elusive over the last four years. While the imminence of recovery has been regularly invoked since the second half of 2009, nineteen of the EU’s twenty-seven member states had, by December 2012, still not recovered to the output levels of 2008, as evidenced by Figure 1.10. Furthermore, of the nine other states (Austria, Belgium, Estonia, France, Germany, Malta, Slovakia, Sweden, Poland), only three are showing recoveries of any note: Poland (+13 per cent), Sweden (+6.2 per cent) and Slovakia (+5.1 per cent).

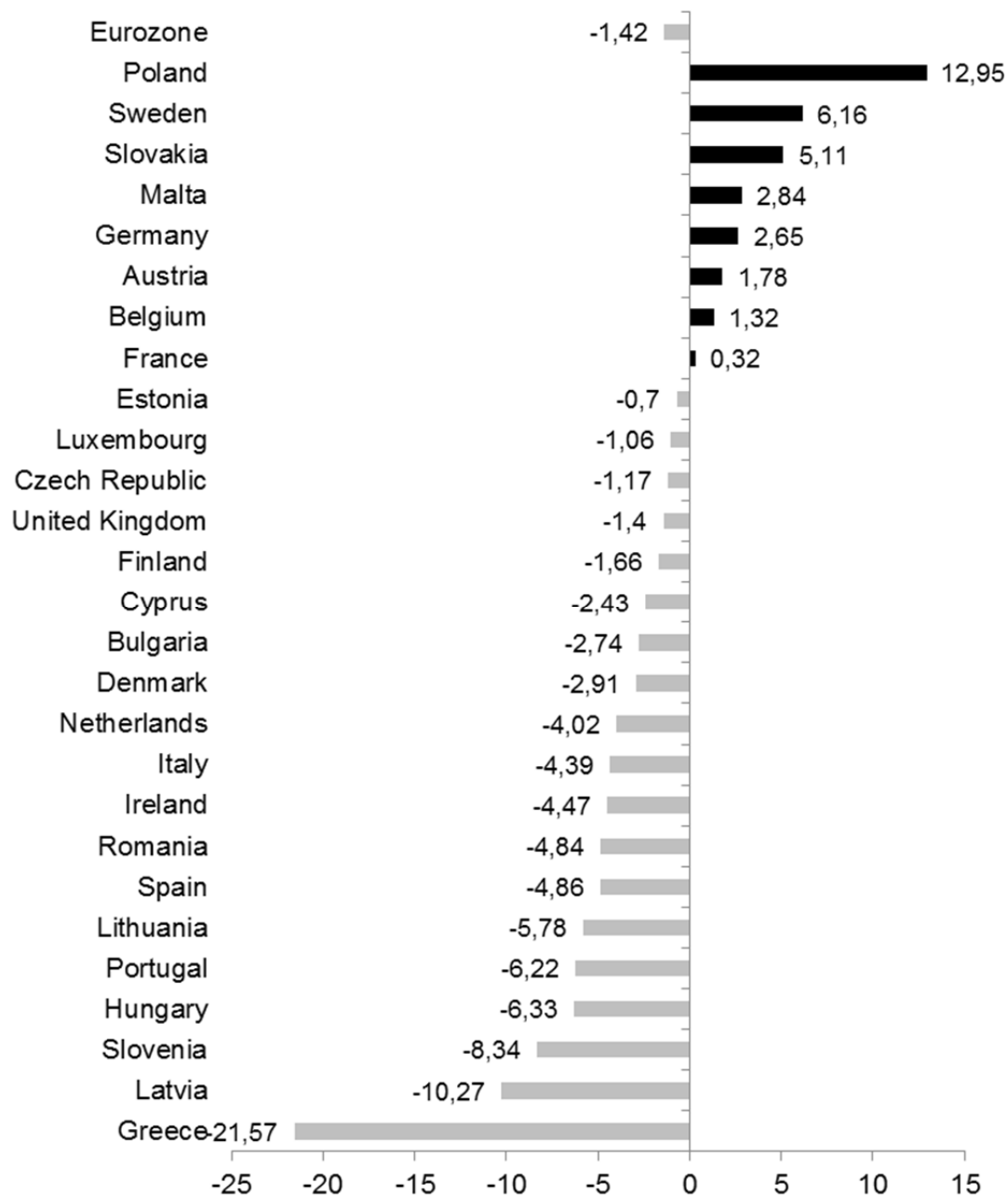


Figure 1.10: Real GDP growth of EU27 member states 2008–2012. Source: OECD; Eurostat; own calculations.

Final quarter figures for 2012, published by Eurostat six days after the MFF, on February 14, confirmed that the eurozone had contracted by 0.9 per cent year-on-year in the last three months of 2012, with the EU27 averaging -0.6 per cent). The marginal recoveries of France and Belgium since 2008 are in reverse with year-on-year falls in GDP of -0.3 per cent and -0.4 per cent respectively (Eurostat 2013b). The OECD in December was forecasting a further decline of eurozone GDP of -0.1 per cent, with recessions in six of the EU27's

OECD members; Greece is due for a sixth consecutive year of contraction in 2013, Italy for its fourth year of negative growth out of six, Spain and Portugal (fourth in five years), Slovenia and Hungary (third in five years). The IMF's February update of its 2013 forecast suggests a contraction of -0.2 per cent in the eurozone. There is, however, a strong case to suggest an even worse outcome for European economies in 2013, given the constellation of domestic demand factors, all of which are set to contract further in the current year.

Most critically, eurozone gross investments – already at just 83.2 per cent of 2007 levels in 2012 – are forecast to decline further, by -1.9 per cent according to OECD December 2012 estimates. While the reluctance of Europe's (non-financial) enterprises to invest can be rightly blamed in part on the corresponding reluctance of banks and other financial institutions to provide affordable credit as a supply-side factor (European Central Bank 2013: 115), the persistence of very low levels of capacity utilisation – as indicator of demand – arguably represent an even more significant obstacle to any sizeable recovery of investments in either commercial property or equipment.<sup>7</sup> The European Union is thus set to remain the least dynamic economic region in the world.<sup>8</sup>

The absence of any signs of significant growth in all three components of domestic demand draws our attention to the other pillar of the European Council's strategy, revealed on February 8, namely trade as the primary vehicle for general economic recovery. Sixteen of the nineteen paragraphs in the general conclusions (EUCO 3/13) are devoted to the EU's 'ambitious trade agenda', outlining the way in which this can make 'a significant contribution' to (e)nhancing sustainable growth' (§1). Apart from the continued pursuit of 'free, fair and open trade' via multi-lateral 'regulatory convergence' (§2), this document stresses the particular importance of enhancing bi-lateral

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<sup>7</sup> Capacity utilisation, having slumped from 84.3 per cent in the EU27 (EU17: 84.7 per cent) in 2008 to 71.1 per cent in 2009, recovered to 80.5 per cent in 2011 but had declined to 77.4 per cent in 2012: IV (EU17: 76.9 per cent), with just a marginal improvement in January 2013 to 77.6 per cent (77.2 per cent). C.f. European Central Bank, *Monthly Bulletin*, various; European Commission 2013: 9.

<sup>8</sup> It is noteworthy that the CIA World Factbook places the EU in 189<sup>th</sup> position in its league table of GDP growth for 2012, with 22 EU member states in the bottom 60: <<https://www.cia.gov/library/publications/the-world-factbook/geos/ee.html>> (last accessed 14 April 2014).

links with 'key partners', most notably the USA, Japan, Canada, Russia, China, The Association of Southeast Asian Nations (ASEAN), the Common Market of the South) (MERCOSUR) and the eastern 'neighbourhood' (§6-8).

The reader is asked to believe that this 'ambitious trade agenda' will lead 'in the medium term to an overall increase of 2 per cent in growth and to the creation of two million jobs' (§1). Given the lack of supporting evidence for this claim, there are minimal grounds for optimism in the Council's confident predictions. The reasons for a pessimistic assessment of the EU's strategy are many and varied. The systemic factors which suggest short-, medium- and long-term failure will be examined later in this paper. At this juncture, a few remarks about a policy of export-led recovery in Europe will suffice:

- Over 60 per cent of the EU member states' exports involve intra-EU trade; intra-EU trade declined by 6 per cent in 2012, intra-eurozone trade by 7 per cent (Eurostat 2013b: 28); with stagnation/austerity depressing domestic demand factors within the EU27, the predictable outcome for this predominant mode of European trade is a continuing contraction of intra-EU trade volumes.
- Exports to non-EU countries constitute 14.1 per cent of GDP in the EU27; furthermore, 73.5 per cent of extra-EU trade is accounted for by just six economies (Germany, Italy, France, UK, Belgium and Netherlands), slightly more than their share of regional GDP (70.7 per cent). The main thrust of any export-contribution to growth (net exports) will therefore come from these six economies and will have to be considerably greater than +2 per cent in order to compensate for the decline in both domestic demand and intra-EU trade. Net exports of the same order as Germany's postwar average of some +3.2 per cent (1950-1980) would be required over an extended period to achieve this objective; even if such a strategy were considered desirable, its feasibility is very questionable.
- There is an assumption in the growth-through-trade logic that - in terms of extra-EU trade and payments - the EU27/EU17 is a unitary 'actor' where the standard dynamics of neo-classical international economic relations apply, i.e. there is a rebalancing of those relations towards equilibrium via the current account, the capital account and the exchange rate through the operation

of open markets. That is, both Europe's problems of competitiveness and its growth weaknesses can be addressed by providing easier access for the EU's exported goods and services. There are several problems with this assumption, not least that the EU's aggregate external balances and aggregate growth rate are the primary measures of success when assessing the region's performance and the quality of the Commission's crisis management. While it might be possible to exploit hitherto untapped demand for European goods, there should be no illusions about either the likely beneficiaries of such demand (namely the core states noted above) or the predominance of high-grade industrial goods in such trade (vehicles, chemicals, electro-technical goods), again originating within the so-called 'blue banana'.<sup>9</sup>

- An undifferentiated policy of growth through further trade-liberalisation reflects, above all, the critical neglect of *intra-EU/intra-eurozone trade and payments asymmetries* as fundamental features of Europe's structural problems. These and other asymmetries were ignored by the authors of the Maastricht Treaty in 1992, of the Stability and Growth Pact in 1997 and of the Fiscal Compact of 2012. The 'design faults of the European Monetary Union' (Arestis and Sawyer 2011) and to a lesser extent of the Single Market are rooted in large measure in this neglect and in the faith that such asymmetries are resolved through the operation of 'efficient' markets. The, now deeply entrenched, regional crisis triggered by the collapse of the global financial system in September 2008 has exposed both the huge disparities in external economic balances (Figure 1.11) and the folly of neglecting their macro-economic effects on the part of both the Commission and major member states, particularly in relation to the evolution of interest rate spreads on sovereign bonds (Figure 1.12).

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<sup>9</sup> The 'blue banana' denotes the strip of highly urbanised, highly industrialised territory stretching from the North-West of England through France, the Benelux, western Germany, to northern Italy and which accounts for a high proportion of both industrial production and industrial and commercial innovation in Europe; machinery and transport equipment exports constitute a full 42.2 per cent of all extra EU-27 exports, with manufacturing accounting for 82.6 per cent (Figures from Eurostat 2011: 56).

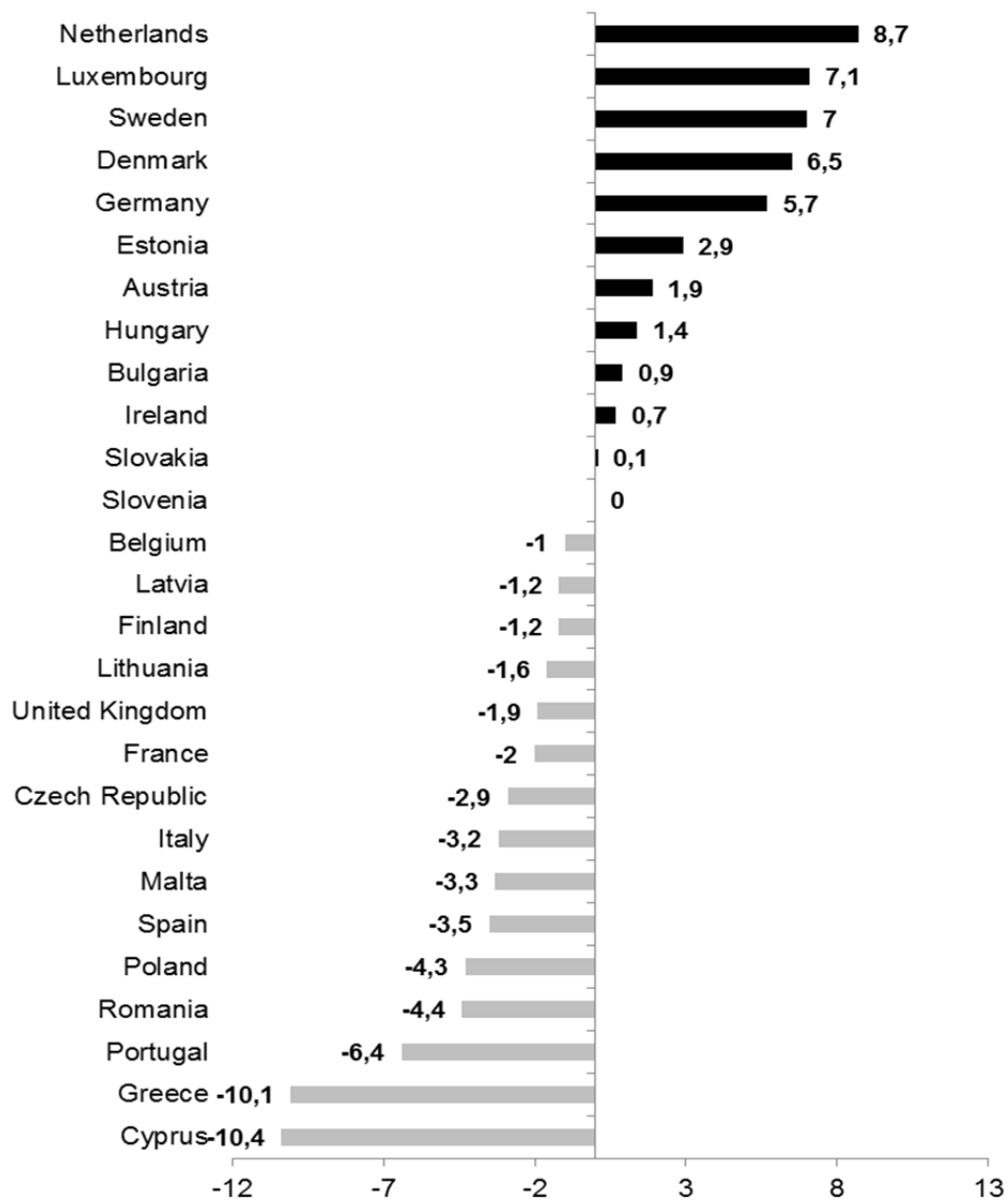


Figure 1.11 EU27 current account balances as a percentage of GDP 2011.

Source: Eurostat: European Union balance of payments [bop\_q\_eu]

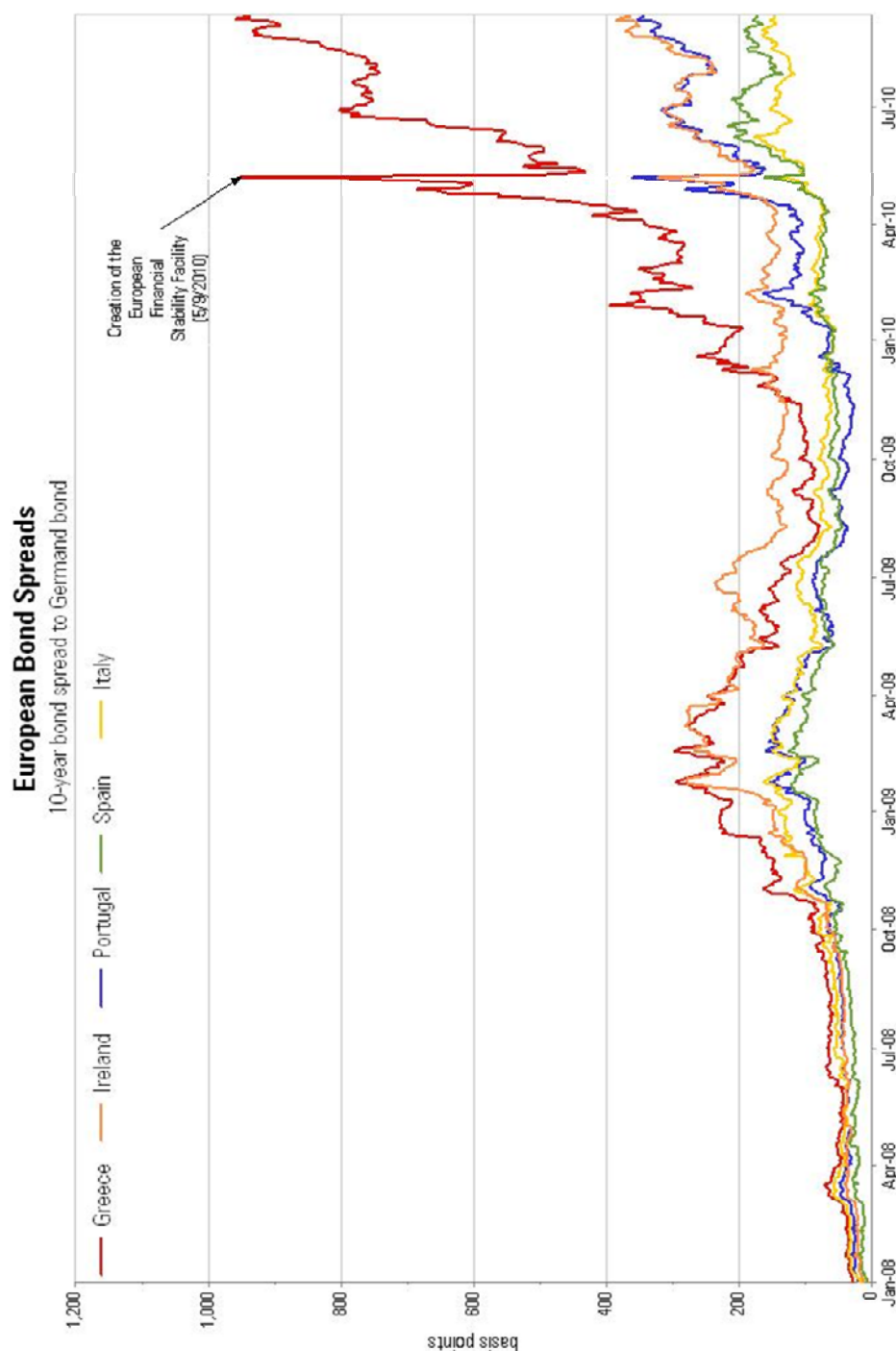


Figure 1.12: The divergence of interest rates on fixed interest sovereign bonds 2008–10.

Source: Econweekly, 10 September 2012

- 17 out of the EU's 27 member states have significant trade deficits; 15 member states have serious-to-chronic current account deficits and five member states have chronic current account surpluses (Netherlands, Luxembourg, Sweden, Denmark and Germany).



With 9 deficitary states locked into a monetary union with key states with chronic surpluses (Germany and the Netherlands), their competitive disadvantages (of lower productivity and higher rates of inflation) cannot now be neutralised by exchange rate adjustments. Furthermore, those competitive disadvantages are amplified, firstly, by the need to balance current account deficits through the capital account, by persuading foreign investors to purchase sovereign bonds, secondly by both the upward pressure on interest rates and the associated speculative attacks on bond-related derivatives markets and thirdly by the down-grading of the sovereign bonds of individual countries by credit-rating agencies (EuroMemo Group 2012: 32).

Figure 1.12 indicates the extent of the problem of bond-spreads for the eurozone and the rest of the EU from an early stage in the global crisis. Where pre-crisis spreads of Greek sovereign bonds against 10-year German Bunds had fallen to as low as 10–30 basis points (Tavlas, Hall and Gibson 2011: 6), 2009 saw an early destabilisation of the bond market, with spreads stretching to 300 basis points in the Spring, with later spikes in the winter of 2009–10, exceeding 900 basis points (9 per cent) in May 2010. From the outset, there were proposals for the issuance of common Eurobonds<sup>10</sup> as a means of preventing the destructive effect of wide bond spreads on sovereign borrowing costs and overall sovereign debt. All such calls have been resisted, in particular by the recent German centre-right coalition government under Angela Merkel. While the various stabilisation measures adopted by the EU (European Financial Stabilisation Mechanism, European Financial Stability Facility, European Stability Mechanism) have achieved a marginal narrowing of spreads, the overall damage inflicted on the Greek, Portuguese, Spanish and Italian economies by higher-than-necessary borrowing costs and by pro-cyclical conditionalities, attached to EFSM. EFSF and ESM loans, provides overwhelming evidence for the culpable dilatoriness of policy-makers in addressing the structural asymmetries summarised above. Münchau (2011)<sup>11</sup> talks rightly of ‘financial illiteracy’.

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<sup>10</sup> See, for example W. Münchau ‘The benefits of a single European bond’, *Financial Times*, 25 January 2009.

<sup>11</sup> W. Münchau ‘The only way to save the Eurozone from collapse’, *Financial Times*, 13 November 2011.

Export-led growth, flanked by domestic deleveraging – of households, enterprises and states – is indeed a highly questionable strategy. Raghuram Rajan, former chief economist at the IMF, describes this strategy as one of the major ‘fault lines’ of the global economy in recent decades, in particular as it relates to states like Germany that have deliberately depressed domestic demand to optimise their international competitive advantages (Rajan 2010: 46–67). In particular the accelerated erosion of public investment in particular crisis-hit countries, like Spain, Greece and Portugal will compound their competitive disadvantages and postpone the economic convergence of peripheral economies that is the precondition for the survival of the European project. In Spain, government spending on R&D is reported to have been cut by 40 per cent since 2009, reinforcing a brain-drain of scientists and technicians<sup>12</sup>, mirroring similar developments in Greece (Trachana 2013) and Portugal (Caldas 2012). There is a grim irony to such death-blows to the ‘Lisbon Strategy’.

## End the tyranny of neoliberalism

In an interview with the German daily, *Die Welt*, the former president of the German Bundesbank, Helmut Schlesinger, suggested that the money issuance of the European Central Bank had reached ‘dimensions that are reminiscent of war-financing’ but unprecedented (and by implication unacceptable) in peacetime<sup>13</sup>; accordingly he warned of serious inflationary consequences for the German and European economies. The *war analogy*, designed by Schlesinger to ridicule the irresponsibility of the ECB and its departure from Bundesbank virtues, is in fact much more appropriate than he would ever be prepared to concede. The analysis above has attempted to demonstrate that the neoliberal paradigm (deregulation, financialisation and monetary accumulation) generated a two-fold destruction of value, akin to the devastating effects of war, with neoliberal austerity currently threatening a further period of destruction and depression. The dilution of social wealth since 1980 operated hand-in-hand with the most profound redistribution of income and wealth in modern times, generating serious *diseconomies* for current and future

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<sup>12</sup> ‘Brain Drain in Spain leaves scientific research on the wane’, *Financial Times*, 14 June 2013.

<sup>13</sup> ‘Das erinnert an die Kriegsfinanzierung’, *Die Welt*, 13 March 2012, retrieved from: <http://www.welt.de/print/wams/wirtschaft/article13915232/Das-erinnert-an-die-Kriegsfinanzierung.html> (last accessed 8 October 2013).

generations, even before 2008. Counterfactual estimates would suggest that the well-being of future generations could have been better ensured if the investment ratios and wages ratios of advanced states had remained at their 1980 levels, indeed that their maintenance would have been reciprocally strengthened with the parallel improvements of productivity, wages and consumption. The factual destruction of potential value in the processes of financialisation and the sharp decline in public investments between 1980 and 2008 precedes and pre-programmes the factual and inevitable disaster of both the systemic collapse of monetary accumulation in the winter of 2008/2009 and the subsequent hapless attempts to manage the crisis.

The alarming estimates of potential permanent global output losses of up to \$200 trillion – with current annual global GDP at around \$78 trillion – do not actually begin to illustrate the challenges facing world policy-makers, particularly in the advanced economies. *Recovery from the cataclysm of the Second World War involved arguably fewer strategic challenges than the current mess.* For example, the evident need, after the War, to make good the colossal physical damage to commercial, domestic and public property, to urban infrastructures, to national and international transport networks, was combined with a state-welfarist policy consensus and a profound preparedness to cooperate within and between nations which allowed a rapid transition to growth and prosperity in the 1950s. This was reinforced by the emergence of both consumerism and the technical-managerial means (Fordism) to satisfy the burgeoning demand of increasingly affluent households. *The 2008 crisis manifests none of these auspicious pre-conditions for recovery and reconstruction:*

- There are no general physical signs of a catastrophe to be remedied;
- There is no shared acknowledgement of the unnecessary follies of the neoliberal paradigm as there was of the need to reverse the (unavoidable) privations of war;
- There is no shared diagnosis of the causes and extent of the crisis; there have been no mass resignations from the Economics departments of universities and research institutes in OECD countries; there is no self-evident replacement for a discredited system;

- There is significantly no overwhelming need for a marked increase in consumer goods provision – saturation of markets and unpredictable elasticities of demand predominate;
- There is, above all, no common view about the need for an increase in the provision of public goods, even if an increasing number of voices are raised in support of public goods as vehicles for general human progress.

## Policy options

There are new debates emerging about the nature of economic and social relations and in particular about the need for greater equity and ‘fairness’, and a central role for an active state. The continuing mobilisation of such forces and an intensification of public debate within and across borders is an urgent priority. A number of stark policy-options suggest themselves from the analysis above. These run counter to the policy preferences, currently being pursued by the European Union. The obsessive attachment of Brussels to the German ‘model’ of export-led growth and deflation on the one hand, together with its inexplicable thralldom to the wisdom of credit-ratings agencies and major banks, threatens to condemn Europe to an extended period of stagnation, protectionist nationalism and political fragmentation. The early signs of multi-lateral coordination within the G20 have all but evaporated, weakening one essential pre-condition for effective crisis management. If, however, the ‘rebalancing’ of Europe – as proposed in this paper – is to be achieved, and the destructive tyranny of neoliberal recipes undone, certain basic policy options would seem to be essential:

- **Regulatory Control and Limitation of Banking:** Given the dilution and destruction of value resulting from the irresponsible neoliberal experiment with financialised capitalism and the equally hazardous roll-back of the state, there is an increasingly strong case for the (temporary) *public control of the commanding heights of finance capital* as a means of restoring a modicum of allocatory good sense to the reinvestment of social wealth as a real basis for sustainable human development, along with a much higher level of legitimacy. Political economies that seek to promote the welfare of all of their citizens simply cannot afford financial services that are predominantly *self-serving*, which divert corporate reserves into value-destroying Ponzi-style ‘financial investments’ away from value- and welfare-enhancing

real investments. They cannot operate effectively with a sector whose total balance sheets, as in the case of the UK, grew from just 50 per cent of GDP to 500 per cent of GDP between 1970 and 2008. Financial services essentially need to be returned to the service function of collectively beneficial and controllable circuits of investment, production and consumption.

- **Fairer Distribution:** Additionally, *policy-makers in advanced economies need to address the critical disparities of distribution within the future context of far lower and far less predictable trend-growth; learning to cope with weak or zero quantitative growth while allowing poorer economies to converge towards a sustainable level of qualitative growth is arguably the most critical task facing post-crisis societies.*
- **Public Goods:** Within qualitative growth scenarios, likewise, *the role of public goods in the broadest sense (health, education, legitimacy, social inclusion, distributional equity as public goods) will inevitably become more rather than less significant, in line with Wagner's Law of state tax ratios rising with levels of civilisation. Central to this strategy is the restoration of a strong programme of public investment.*
- **Realistic Rates of Return:** A further challenge to all participants in the recalibrated political economies of the OECD and of Europe is to overcome the structural addiction to unrealistic rates of return that have too long informed the investment strategies of the managers of sovereign wealth funds, pension funds and other investment funds and, by implication, generated the exaggerated management fees extracted from Ponzi-style investment vehicles. Above all, the current and future sustainability of retirement pensions will have to become increasingly the subject of general distributional debates within society concerning their intergenerational equity, rather than of intra-fund adjustments.
- **Deficit-Spending and/or Monetisation as Necessity:** The current contradictory trajectory of European states and their pro-cyclical strategy of growth through austerity (!), represents a public 'bad' which needs to be reversed as a matter of extreme urgency. The analysis above has attempted to demonstrate that the cumulative crises that have hit Europe since 2008 represent more intractable

problems than those facing states in the reconstruction period after World War II. *The levels of sovereign debt in Europe generated by the 2008 crisis are accordingly by no means extraordinary by historical comparison.* The UK's sovereign debt in 1948 was 237 per cent of GDP, that of the Netherlands and Belgium 223 and 118 per cent respectively.<sup>14</sup> It took some 20 years before the debt of these states fell to Maastricht-compliant levels; expecting the EU17/EU27 to achieve these levels by 2013 indicated monumental stupidity. Against the background of the critical asymmetries generated by the neoliberal paradigm and the consequently greater challenges of promoting debt-reduction via growth, the case for tolerating higher levels of debt in the medium term to avoid even greater economic asymmetries and the collapse of the European project, is thus overwhelming, as is the case for Eurobonds within the eurozone. Beyond the simple toleration of debt- and deficit-ratios, however, there is growing momentum within both heterodox and, now, orthodox circles for more radical solutions to Europe's New Depression. These include:

- The **debt jubilee** idea, proposed by economists like Steve Keen (2009)<sup>15</sup> and Willem Buiter<sup>16</sup>, and popularised by a number of financial journalists, e.g. Evans-Pritchard (2009)<sup>17</sup>; this proposal proceeds from the (correct) assumption a) of the impossibility of all economic actors in advanced economies deleveraging simultaneously without inducing long-term stagnation, and b) of the primary culpability of financial institutions in generating historically record levels of private debt. The 'jubilee' involves finance ministries (via central banks) financing the wholesale repayment of private debt by means of unsecured money issue as

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<sup>14</sup> Reinhart, C. and Rogoff, K. (2012) 'This Time is Different: Eight Centuries of Financial Folly', Statistical database, retrieved from:

<<http://www.reinhartandrogoff.com/data/>> (last accessed 13 August 2013).

<sup>15</sup> See also 'Steve Keen on BBC Hardtalk', retrieved from <[http://www.youtube.com/watch?v=rGkmgnprrIU&feature=player\\_embedded](http://www.youtube.com/watch?v=rGkmgnprrIU&feature=player_embedded)> (last accessed 13 August 2013).

<sup>16</sup> Buiter, W. (2009) 'Quantitative easing, credit easing and enhanced credit support aren't working; here's why', *Financial Times*, Willem Buiter's *Maverecon*, 3 July 2009, retrieved from: <<http://blogs.ft.com/maverecon/2009/07/quantitative-easing-credit-easing-and-enhanced-credit-support-arent-working-heres-why/#axzz2r8j6hF10>> (last accessed 13 August 2013).

<sup>17</sup> A. Evans-Pritchard 'Biblical debt jubilee may be the only answer', *The Telegraph*, 19 January 2009.

the most effective means of neutralising the current paralysis of financial circuits and encouraging growth via debt-free consumption and investment. Keen, who is strongly influenced by Hermann Minsky, asserts current crisis-management measures are entirely inadequate to cope with the colossal (and underestimated) scale of the crisis, equivalent to ‘bailing out the Titanic with a thimble’ (2009: 3). It arguably remains a question of faith, how the transmission belt of debt-forgiveness will function in revived circuits of consumption, investment and finance, but the radical diagnosis is certainly apt, as is the perception of an urgent need to constrain speculative finance (*ibid.*: 21).

- A related but arguably more refined policy-prescription involves the creation of so-called **helicopter money** or the selective monetisation of government expenditure. This example of ‘thinking the unthinkable’ has been strikingly popularised by the *Financial Times*, in particular Martin Wolf<sup>18</sup> and by the outgoing chairman of the UK Financial Services Authority, Adair Turner. Turner in particular takes issue with Germany’s obsession with hyperinflation and its neglect of Brüning’s depression economics and its ushering-in of fascism: ‘Is [monetary financing] desperately dangerous because every pound of money financed turns into inflation? Absolutely not. There is no coherent rigorous bit of economics that takes you in that direction’<sup>19</sup>. In contrast to the debt jubilee stimulating private demand, the monetisation proposals behind helicopter money tend to focus on state-managed, targeted investment projects in infrastructure and other public goods. McCulley and Poszar (2013) provide the most coherent and persuasive argument for both helicopter money and for a more decisive coordination of fiscal and monetary policy as vehicles for

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<sup>18</sup> M. Wolf ‘A Case to Reconsider the Basis of Monetary Policy’, *Financial Times*, 8 February 2013; M. Wolf ‘The Case for Helicopter Money’, *Financial Times*, 12 February 2013. See also ‘Helicopter Money and Supply Siders’, *Financial Times* (Editorial), 6 February 2013.

<sup>19</sup> ‘Print money to fund spending – Turner’, *Financial Times*, 6 February 2013, retrieved from: <<http://www.ft.com/intl/cms/s/0/1be21d54-6fb5-11e2-956b-00144feab49a.html#axzz2hmaRZauF>> (last accessed 15 October 2013). Wolf, M. ‘The Case for Helicopter Money’, *Financial Times*, 12 February 2013, comes to a similar conclusion: ‘I fail to see any moral force to the idea that fiat money should only promote private spending’.

recovery; they also provide convincing arguments to demolish the inflation-fears of German and other opponents of monetisation.

## **Reconfiguring economic governance in Europe: public goods, taxation and the state**

In December 2008, it seemed as if at least one practical lesson had been learned by both policy-makers and civil society, namely that the role of the state was, contrary to the prejudices of the preceding 30 years, central to the survival of capitalism and the continuous management of its deficiencies. The deployment of colossal volumes of public resources to provide life-support to national financial institutions as well as international networks of banking and payments, should at least have laid to rest the delusion of 'the' markets' self-healing properties. The call for decisive political action, for international cooperation and coordination was deafening; the response of EU, G7, G20, the Federal Reserve, the European Central Bank, Bank of England, the World Bank and the IMF was admirably urgent. National, international and supranational governance and re-regulation was seemingly acknowledged as pre-conditions for recovery. By the same token, the financing of salvage operations for banks and of counter-cyclical stimulus packages via budget deficits enjoyed at the very least the tacit support of the economic elites and the citizens of the advanced economies.

However, despite such auspicious beginnings, 2009 saw the rapid return of what Richard Murphy has recently coined 'the cowardly state' (Murphy 2011) with the re-assertion of the primacy of deflation and debt-consolidation among key EU states and at Commission level. The opportunity to reflect on failure and alter course has thus been woefully squandered, raising the suspicion that a neoliberal policy-elite is indeed using the opportunity to 'finish the job', to complete a pan-European neoliberal strategy (Buckel *et al.* 2012: 30ff) and weaken European social provision even further as a supply-side inducement to retain the loyalty of capital (Lehndorff 2012: 24).

The 'competitive state' (Hirsch 1995) is the opposite of the activist state of New Deal Keynesianism; it is not even the ordoliberal state, pursuing national mercantilist goals, but the subaltern set of institutions within an interdependent network, controlled by transnational capital as a hierarchised historical bloc. The capture of



Europe's advanced states by transnational capital epitomises Hufschmid's notion of 'deformation'. Replacing these deformed structures of governance Europe-wide with new institutions of collective, multi-level democratic control with strong commitments to harmonised principles of active and socially just fiscal policies is the fundamental challenge for this and future generations of European civil societies. The obstacles in the way of both salvaging what is left of 'social Europe' are considerable and have been multiplying since the aggressive reassertion of pro-cyclical, neoliberal debt-reduction programmes in 2009. What is also becoming increasingly evident is that the challenge is one of a fundamental, socio-cultural nature, made particularly problematic by the capitulation of many established, social democratic parties to key tenets of the neoliberal revolution; indeed the capture of these parties and of significant sections of both electorate and civil society by interest-driven media campaigns and their sanctification of consumerism and individualism helped to generate new waves of expectation in relation to lifestyle, income, expenditure, pensions which were critically dependent on Ponzi-style capitalism. These effects have survived the collapse of the latter and, at the very least, interfere with processes of reflecting on and recalibrating those lifestyles. The competition states of Europe have, through their collective powerlessness and their separate degrees of national failure, also contributed to a weakening of faith in conventional democratic politics, where resignation and cynicism would seem to be stronger than reflective, dynamic opposition to the historical bloc, even if that opposition is growing.

The neoliberal programme of crisis management is set to intensify the competition between member states as they dilute further their provision of public goods, services and social security; the 'race to the bottom' is accelerating (Genschel *et al.* 2011). Hitherto, this 'location competition' has increased the disparities in the external balances of the EU, in particular within the eurozone, with German current account surpluses growing in relation to most other member states (Lehndorff 2012: 92). The demand and supply asymmetries between eurozone members are mirrored by the shift in demand structures in individual countries, with weak domestic demand in Germany offset by increasing dependence on export demand as a vehicle for growth. Further demand asymmetries have been generated by the growing disparities in income distribution.

Persisting with the German 'model' will exacerbate rather than alleviate these asymmetries. Rebalancing them is a precondition to European recovery. A precondition for altering course is the *refining and radicalising of politico-economic discourse in the civil societies of all member states*. This requires, at the very least, a *coalition of forces against neoliberal orthodoxy and the influence of transnational capital*. The initial primary focus of this coalition must arguably be the restoration/creation of the active fiscal state which redistributes social resources for the benefit of the overwhelming majority of its citizens – the 99 per cent as the central banner of the Occupy movement suggests. Fiscal rebalancing has to be rooted in a *European consensus about the very purpose of taxation*. Annamaria Simonazzi summarises the challenge correctly as an educational task:

The understanding of taxes has to be linked to the understanding of services: people have to learn again, that it is their health, that it is education, kindergartens and the care of the elderly, that they pay for.

(Simonazzi 2012: 194)

Currently, the absence of a serious revenue dimension to fiscal harmonisation represents Europe's greatest structural deficiency in policy-making; monetarist strictures about debt and expenditure predominate. One of the few successful initiatives in the direction of tax harmonisation – the European Savings Directive – has been fatally weakened by the bilateral tax deals between Switzerland and two of the EU's major neoliberal strongholds, the UK and Germany. A sensible point of departure for a broad, pan-European opposition to the destructive effects of such wilful beggar-thy-neighbour policies and the EU's historical failure to promote tax harmonisation (Leaman 2012a) would include the elements outlined below:

#### Box 1.2 Towards a new fiscal consensus in Europe

1. A Fiscal Union and Settlement Union of the EU17 based on the long-term commitment to eradicating poverty, unemployment and social exclusion; as a Settlement Union the eurozone would deploy its resources collectively to ensure the relative convergence of external balances, of national and regional ratios of investment, private consumption and public consumption to GDP against the condition to outlaw fiscal free-riding with the abolition of tax and regulatory competition and a relative

convergence of states with low tax ratios (see Ireland, Greece, Portugal) to a higher average.

2. A constitutional rearrangement of Europe's policy architecture, removing the democratic deficit of an autonomous, unanswerable European Central Bank, establishing the obligation for policy coordination between fiscal authorities and monetary authorities and a policy brief based on economic, social and environmental sustainability.
3. The Fiscal Union of the EU17 would allow deficit-spending for anti-cyclical purposes and for structural modernisation, without the imposition of arbitrary ceilings to deficits or overall debt (no Debt Brake!) and with mutually assured Eurobonds.
4. Fiscal harmonisation within the EU27 which ends tax competition, establishing minimum standards for direct and indirect taxation, maximising transparency, automatic information exchange and compliance-policing:
  - Agreed minimum rates of personal income tax (PIT) and corporation tax (CT);
  - Commitment to the principle of progressive income taxation (phasing-out of flat-tax regimes and relative convergence of scales of progression);
  - A Common Consolidated Corporate Tax Base;
  - Country-by-Country reporting/Publish What You Pay;
  - Formulary Apportionment associated with CBCR;
  - Restriction of national variations of special allowances on both PIT and CT to the purposes of rectifying current account asymmetries and productivity disparities;
  - Outlawing of European tax havens/secret jurisdictions;
  - Boycott of financial corporations and other companies operating 'brass plate' business in overseas tax havens;
  - Tax avoidance to be made as ethically unacceptable as human trafficking.

The restoration of a strong and well-resourced fiscal state represents a *minimum consensus* around which progressive forces in Europe could and should be mobilised. On these foundations, the obstacles to sustainable social development could be removed and the objectives

of a courageous, activist state could be addressed. The removal of the legal, institutional and organisational pillars of neoliberalism – as the historical means of social and economic ‘deformation’ – would be as radical as the original Thatcherite ‘revolution’:

- The public ownership of utilities as natural monopolies should be restored and other sources of monopoly rents (Private Finance Initiatives, e.g.) eliminated. The provision of water services, public transport, power distribution, health, education and social welfare as public goods is the natural function of the public sector; the commodification of those services as a vehicle for the direct valorisation of capital is incompatible with a society committed to collective responsibility for the welfare of its citizens, based on solidarity, social justice and democratic legitimacy. The recent accelerated privatisation of public utility companies and service providers as a condition for EU assistance for states with temporary sovereign debt problems (Greece, Portugal) must be reversed; securing comfortable income-streams from monopoly franchise/supply operations inflates rate-of-return expectations and reduces entrepreneurial incentives to invest in commercial activities that are subject to market pressures.
- The on-going paralysis of commercial investment in many EU countries is in part informed by the distortions in profit expectations generated by 30 years of neoliberal privatisation. This paralysis furthermore demands a long-term role for the public sector in underpinning national and regional investment demand and has consequently informed a number of proposals by progressive economists for the establishment of *state-owned investment banks* to fill the void left by coy private banks (Murphy 2011: 274ff) and for the European Investment bank to fund infrastructure projects (EuroMemo Group 2010: 4, 40; EuroMemo Group 2011: 3, 34); state investment banks would be financed directly by central banks, by-passing the hitherto fruitless and dubious route involving liquidity injections into private banks.
- The third key function of the active state is to counteract the pernicious redistribution of income and wealth that has characterised the neoliberal era; this cannot simply involve the secondary transfer of state resources to produce a less inequitable distribution of net incomes, but *must also address the more critical*

*and growing disparities of market incomes*; the record of the UK Labour government (1997–2010) demonstrated the haplessness of an anti-poverty strategy that neglected the central function of market distribution, deploying colossal volumes of state transfers merely to prevent a further rise in an already high Gini coefficient (see Leaman 2013). Fiscal transfers play an important but secondary role, compared to statutes of industrial and employment law which allow productivity increases and profit growth to be reflected in the growth of real wages. Ending the destructive tyranny of neoliberalism represents a colossal challenge, not just in the mechanical delivery of a radical new policy-mix, but above all as an intellectual and cultural learning-process. Such change cannot be delivered by an insurrectionist vanguard in individual nation-states, but by a broadly-based, well-informed, dynamic coalition of progressive forces operating at a variety of levels – local, regional, national, global, virtual. We need such a coalition to ensure that we bequeath our grandchildren halfway adequate foundations for decency, justice, sustainability and coexistence.

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